



Welcome to this quarter's newsletter.

As mentioned in previous correspondence from us, the first provisional tax payment for most clients is due 28th of August. Remember, if you are registered for GST, this is to be paid with your July GST on your GST return (look on the reverse side of the return).

If you are registered for GST on a 6 monthly basis, your provisional tax is payable in two instalments only and the first payment is due on the 31st of October along with your GST payment.

Please talk to us if you have any queries regarding your tax position.

Best regards
Anna, Bryan, Richard & the team at
Pocock Hudson.

DONATIONS AND REBATES

Limits relating to donations deductions for companies and the donations rebates for individuals have been removed from the 2008 – 2009 income year. As a result of the changes, companies will be able to claim a deduction for donations up to an amount equal to net income. Individuals will be entitled to a tax rebate of one third of their donation, limited to the amount of the person's tax credits for the year. Previously, both companies and individuals were subject to limits on the amount of deductions and rebates, respectively, that could be claimed.

In the past the IRD were reasonably practical, even relaxed when it came to processing applications for an individual's

donations rebate. However, as these changes are likely to result in an increase of tax being refunded by the IRD, there was uncertainty regarding whether the IRD would increase their scrutiny during the processing of donations rebates. The uncertainty arose because the legislation prescribing who could claim a donation rebate simply refers to a person who makes a gift. There has been concern that where a donation receipt is issued in the name of a non-working spouse who has no tax credits, the donation rebate would be disallowed by the IRD. The issue has recently been clarified by the IRD.

- Where a donation is made in joint names, both parties are eligible to claim either the whole, or part, of the rebate, provided the combined claimable amount does not exceed the donation, and that the amount either individual is claiming is not greater than their personal taxable income.
- Where a donation is made solely by one spouse, and that donation exceeds that person's taxable income, the other spouse can claim the balance of the donation, up to the amount of the other spouse's taxable income.

Irrespective of which spouse is named on the receipt (or both - jointly), if more than one claim is made relating to a donation, one spouse must attach the receipt to the claim form. The other spouse must attach a note to their claim form giving the name and IRD number of their spouse with whom they intend to share the claim.

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For example, if a married couple makes a donation and the receipt is issued in the name of the spouse with no taxable income, that spouse would be unable to claim a donations rebate. However, if the other spouse has taxable income greater than the donation, that other spouse may claim the entire donation amount.

The following situation illustrates the need for companies to be aware of how the new rules work before gifts or donations are made. Consider a motor vehicle dealership that wishes to donate a new vehicle to a worthy charity. The vehicle is donated, and the charity is very appreciative. If the company expects to claim a deduction based on either the cost or market value of the vehicle, it may be surprised to find a deduction will not be available. In order for a company to claim a donation as a deduction it has to be a donation in cash.

It is clear that Government has intended increased tax benefits to come from making charitable gifts and donations. There is however, uncertainty as to whether or not this intention will be achieved in practice.

CHANGES TO PARTNERSHIPS

It could be said that in the past there has been little legislation regarding the taxation of partnerships. For example, how partnership profits are to be shared and how the entry and exit of partners are treated in a partnership was not covered by legislation. This lack of legislation has been the cause of uncertainty, and at times frustration, resulting in varying treatments being applied. In order to resolve these issues, Government has introduced new legislation, effective from the 2008 – 2009 income year. These changes have far reaching effects from corporate partnerships, such as law firms, to small family partnerships, such as 'mum and dad' farming partnerships.

The treatment of partnerships as a 'look-through' entity, taxing partners at their individual rate as opposed to at

partnership level, has been strengthened under the new legislation. In practice, each partner is considered to conduct the business of the partnership to the extent of their interest in the partnership, rather than the partnership conducting business on its own account. Income streaming, the practice of streaming income to a partner on a lower income, is expressly precluded, with income being allocated to partners based on their interests in the partnership.

With respect to disposals of partnership interests, when a partner exits the partnership, difficulties have arisen because technically a change of partners results in the dissolution of a partnership and the formation of a new partnership (with new partners). The existing partners effectively dispose and reacquire their share of the assets. Practitioners have generally ignored the technical aspects, choosing to take a more practical approach.

A general rule has been introduced which provides that partners own their respective shares in the underlying assets and liabilities of the partnership. This means that when a partner exits the partnership, that partner disposes of that particular interest and the other partners and their interests are not affected. This limits tax outcomes, such as depreciation recovery income, to the exiting partner. However, if the profit received by the exiting partner is \$50,000 or less, a 'step-in' approach is adopted. The new partner is treated as assuming the position of the exiting partner and no tax effect will arise to the exiting partner. Under the 'step-in' approach, the new partner is treated as having acquired the exiting partner's interest at the date the exiting partner's interest was first acquired. Any income or losses the exiting partner derives in connection with the particular partnership share in the income year are treated as being derived by the new partner for tax purposes.

Where the \$50,000 threshold is exceeded, the exiting partner must account for the disposal of the particular partnership

interest. There are exemptions which apply to exclude specific items from being recognised for tax purposes. These exemptions relate to:

- trading stock
- depreciable tangible property
- livestock
- financial arrangements

If a partnership comprises less than 5 partners these exemptions may be ignored.

It will be important to be aware of these provisions when dealing with partnerships. For example, when negotiating the purchase of a partnership interest, the price that is paid should take into account whether or not the purchaser is assuming any tax consequences on entering the partnership.

THE QUIRKS OF FAMILY ASSISTANCE

Family Assistance legislation is renowned for being subject to change, including its name, which has recently been changed to "Working for Families Tax Credits". The legislation, as written, creates the impression that it applies to a person employed by a third party on a salary or wage. There are provisions that apply to the self employed and those employed by a related entity, such as a company or trust. However, in some cases, the provisions do not lend themselves to easy interpretation for the purposes of the self employed person. The result is what can be considered as 'gaps' in the legislation.

It is generally well known that the income thresholds that enable a person to receive assistance have increased. As a result, the provisions around the legislation are receiving more and more attention. The following may prove interesting.

Close Companies

A 'close company' is a company where more than half its shares are held by five or fewer shareholders that are 'natural persons.' Where a person has 10% or more of the shares in a close company the income of the company must be apportioned to the person based on their shareholding, to determine their income for family assistance purposes. The obvious example would be a company with all its shares held equally by the parents of three children. However, if the same shares were held by a family trust, it would no longer meet the definition of a 'close company' (i.e., a trust is not a 'natural person') and the income of the company is ignored for family assistance purposes.

In-Work Tax Credit

One of the 'gaps' in the current legislation relates to the 'In-Work Tax Credit' component. One of the requirements to receive the payment is that a person (or their spouse) must be a "full-time earner receiving income from a work activity". In some cases people who work for their own company may not actually receive any income from their company, for example where no shareholder salary is paid. It is understood that in these cases the IRD is not allowing payment of the 'In-Work Tax Credit' as no income has been received by the person from their employment. It is unclear from the legislation what amount of income would be required. It would seem unreasonable to pay a market salary to a shareholder in order to receive the tax credit, whilst the company makes a loss as a result of the salary.

Loss Attributing Qualifying Company

If a person is attributed a tax loss from a 'loss attributing qualifying company' (LAQC) that loss is excluded for the purpose of determining their income for family assistance purposes. A common example would be a rental property held

by an LAQC, where any attributed losses from the rental company would be excluded. If however, that rental property were held personally and the rental activity does not amount to a 'business' (which is likely in the case of only 1 or 2 rentals), then that rental loss can be included for family assistance purposes. This has arisen as a result of the legislation requiring that a loss derived from a 'business' operated by a person be excluded. This rule can therefore be applied to any activity entered into by a person, for the purpose of deriving taxable income that results in a loss, as long as the activity does not amount to a 'business.' What constitutes a 'business' is determined by a number of factors such as the commitment of time, money and effort.

These points should be kept in mind by anyone currently receiving or expecting to receive 'Working for Families Tax Credits'.

RECRUITMENT IN A TIGHT NEW ZEALAND LABOUR MARKET

With unemployment currently sitting at 3.4%, finding new (and suitable) employees in order to grow is becoming more and more difficult for businesses across a range of sectors. Fifty percent of New Zealand firms have indicated that a lack of skilled workers was their most significant barrier to expansion. This contrasts with 44% of Australian firms, 34% of Canadian and UK firms and 26% of enterprises in the United States.

How to attract them in first place

Building a strong employer brand will be increasingly important for organisations to attract and retain staff as pressure on the labour market continues. A brand needs to be uniform across all mediums of communication that a business uses. For example, a sharp and professional print advertisement needs to be backed up by a sharp and professional website, especially if a potential candidate is referred to the

website for further information. This type of branding is key for 'Generation Y' job seekers who base their impression of a prospective employer on the 'look and feel' by their website and the information provided within. A boring website can indicate a boring business or at the very least one that does not bother to keep up with current technologies.

Businesses also need to be more open to employing diverse types of staff to counter staff shortages. A significant proportion of businesses are employing people with a disability, people who have English as a second language or mature aged people.

Lastly, it is important for businesses to keep in mind that a bad hire is worse than no hire as ineffective and potentially destructive employees will cause greater stress than having no-one at all.

Retaining staff

Attracting new employees is only half the problem, employers also need to keep those they already have by offering an appealing mix of work, salary, benefits and culture that is unique to their business. This is not easy, and one package will not fit all employees, from new recruits to star performers.

The trick in this tough and competitive labour market is to be proactively offering market rates around salary and benefits and then provide an edge by promoting the aspects of the company that make it unique and special.

The new flexible working hours legislation will also be of key importance to many groups of employees. For some, their employer's adoption of such principles may determine whether or not they stay or look for a role offering greater flexibility to suit their lifestyles. Furthermore, if an employer is hiring new staff on higher rates than existing staff every effort should be made to keep existing staff happy and feeling that they are paid fairly.

Getting them back in the future

Businesses that lose employees to the big 'OE', family commitments and the like can also apply strategies to get those employees back when their circumstances change. A business that can create and leave a good impression is much more likely to regain these employees, albeit five years later. Such factors as offering long term leave without pay, sabbaticals and an alumni programme could all play a part in this.

The labour market that businesses have to operate in is changing rapidly and has new and perhaps even bigger challenges ahead than the current skill shortage. So by being proactive and constantly analysing how to better meet the changing demands of both the current and potential workforce, businesses can obtain and keep the employees they want and need.

SNIPPETS

Adding Insult to Injury

After the share market collapse of 1987 there were 'co-incidentally' a number of disputes with the IRD as taxpayers claimed the cost of their shares for tax purposes. This was on the basis that they had purchased the shares on revenue account. These disputes were generally decided in the taxpayers favour.

With the recent spate of finance company collapses the IRD has made the first move by issuing a press release stating that "most investors in failed finance companies will not qualify for a tax write-off". In some cases this will also apply to interest income previously taxed but not physically received. This could occur if a person re-invested accrued interest. As the interest will have been applied for the investor's benefit they will technically have received it and not be able to claim a deduction for a bad debt.

The press release can be viewed under the 2008 media releases on the IRD website at www.ird.govt.nz.

Recent IRD Alert

The IRD uses a 'Revenue Alert' system to notify the public of issues of concern. The IRD has recently issued its second 'Revenue Alert', outlining its view that tax avoidance may exist where taxpayers operate a business of providing personal services through a company or trading trust. Personal services income is income that arises from personal exertion, for example, services provided by doctors, lawyers and electricians etc. The use of such a structure can enable income to be directed to recipients on comparatively lower marginal tax rates. This issue has been around for some time now, most famously covered in the Taxation Review Authority Case W33 involving a trading trust.

The question of whether or not tax avoidance exists can be very complicated to answer and cannot be covered in detail in the context of a 'Revenue Alert.' The issue that may arise going forward is that officers of the Department may take a simplistic approach to the issue and deem a structure to be tax avoidance (simply because it 'fits' with the situation in Case W33) when it is in fact a completely legitimate structure.

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