



# the right read

## Pocock Hudson

MARCH 2007



*It is amazing how fast time flies past these days. It is hard to believe that it is already the end of*

*March - daylight savings has ended and Easter is just around the corner. Hopefully the gorgeous weather that Wellington has been enjoying will stay around for a little while longer!*

*As another financial year comes to a close we again remind you to perform all the mundane but necessary duties before 31 March, such as performing a stocktake and writing off any bad debts.*

*If you require your 2007 accounts to be completed early, please make sure you let us know and send us your information as soon as possible.*

*We hope you have all had an enjoyable summer and look forward to catching up with you soon this year.*

*Best regards*

*Anna, Bryan, Richard & the team at Pocock Hudson.*

### WORKFORCE PLANNING – HOW PREPARED ARE YOU?

In the next 20 years we are going to see a dramatic change in the number of people qualified and available to undertake work. It is predicted that if our birth rate and net migration rate remain at their current levels, New Zealand will be 100,000 people short by the year 2026 to fully support our infrastructure services, let alone for employers to have the number of staff they need to run their business.

Couple this trend with statistics on the workforce in Europe, which are projecting

that over the next 25 years the working age population will reduce by 50 million, and it is not hard to conclude that businesses here need to start thinking about how they are going to source their staff and structure their work in the future.

Not only does the number of people available to work need to be considered, but there is also going to be a more diverse ethnic mix within the New Zealand community. Companies that embrace diversity within their culture will have a greater pool of potential candidates than those that don't. It is expected that within the next 15 years 16% of New Zealand's working age population will identify themselves as Asian, 15.9% Maori, 8.5% Pacific Island and 67% European.

Retiring Baby-Boomers are another issue. Currently 12.5% of our population is retired, but this figure is projected to increase to 25% of the population by 2050. We are going to need those workers in the twilight of their careers to keep working past the standard retirement age. A large proportion of this group will be in a strong bargaining position to determine what work patterns best fit with their lifestyle

To have an edge in the competitive employment market you need to get smart about your people strategies. You need to think about:

- What is it about our company that gives us a good reputation and makes people want to work here?
- What labour intensive roles do we currently have that could be automated?

### THIS EDITION

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- What opportunities can we create in-house to challenge and motivate our staff members so that they remain loyal to us?
- How can we restructure the way we work so that our staff members have the flexibility to meet the competing demands on their lives?

If you think it is tough finding good staff now, then take a deep breath, because it is only going to get tougher.

### IT'S THEIR JOB TO BE FAIR

If the IRD conducts a tax audit that results in an adjustment to a return, shortfall penalties must be considered. Depending on the circumstances, the rules can be black and white, which can leave the taxpayer feeling unfairly treated. IRD has recognised that this result does not promote voluntary compliance.

When section 141 KB of the Tax Administration Act 1994 (TAA) was introduced, which amended the rules surrounding the unacceptable tax position penalty to allow it to be more flexible, it was acknowledged as a temporary measure. The IRD has now released a discussion document, not only looking at permanent solutions to that issue but a number of other enhancements to the shortfall penalty regime. The highlights of that document are as follows.

With respect to the penalty for an "unacceptable tax position", it is proposed that the discretion given to the Commissioner to not charge the penalty under section 141 KB be repealed and replaced with one of the following three options:

- returning to the pre-2003 "unacceptable interpretation" wording;
- limiting the penalty to income tax, i.e. excluding GST and withholding taxes; or

- increasing the thresholds at which the shortfall penalty applies. At present the threshold is more than both:
  - \$20,000 and
  - the lesser of \$250,000 and 1% of the total tax figure.

It is proposed to increase the threshold to more than both:

- \$50,000 and
- 1% of the total tax figure for the return.

The upper threshold of \$250,000 would also be removed.

Presently, if a tax agent is used to prepare a return and that return is later found to have an error, a shortfall penalty for exercising a lack of reasonable care is unlikely to apply. Use of a tax agent to prepare a tax return is recognised as taking reasonable care as long as the agent is given adequate instructions and information. It is proposed to formalise this approach in the legislation but also charge a penalty where a tax shortfall has occurred in the past and the same error or action has been repeated. The logic for this proposal is that the taxpayer, being aware of the earlier error, should have checked the agent's work to make sure the error doesn't reoccur.

The IRD is also proposing to introduce a warning system for late payment penalties. If a payment is not made on time a taxpayer will receive a warning letter and a new due date before a late payment penalty is charged. However, once an extension is given, no further extensions will be given for two years. A late filing penalty for GST may be introduced to replace the current system of applying default assessments. This proposed penalty would perhaps only add additional stress with tighter time pressures for agents in light of the upcoming alignment of GST and income tax balance dates.

It has always been considered unfair that a taxpayer who makes a voluntary disclosure may also be charged with a shortfall penalty. It is proposed that if a taxpayer voluntarily discloses a tax shortfall to the IRD within two years of the tax position being taken, a penalty for "lack of reasonable care" or "unacceptable tax position" will not be charged.

The rules surrounding who can be a tax agent may be amended to give the IRD greater power to exclude individuals who it considers to be inconsistent with maintaining the integrity of the tax system. The rules could apply in situations where taxpayers have been convicted of an offence under the TAA or if they have bad compliance histories in their own affairs or affairs as an agent.

A number of other proposals were considered and rejected. It was disappointing to see that one of the proposals rejected would have seen no shortfall penalty imposed where taxpayers correct their tax positions before the due date. However, depending on the type of breach, the expectation is that this issue will largely be fixed by the proposal to impose no penalty where a voluntary disclosure is made within two years.

On the whole the proposals being considered are a step forward and will be welcomed. The IRD will still retain the ability to punish those who deserve it, but these changes will also force the IRD to soften its approach when dealing with the average New Zealander who is trying to keep the IRD off their back and out of their wallet.

### STUDENT LOAN SCHEME ACT

Since 1 April 2006 student loans for borrowers who live in New Zealand have been interest free. This arrangement has led to an incentive for borrowers leaving New Zealand to not let the IRD know they are leaving the country. A bill was

introduced into Parliament in November 2006 that allows information matching between the Customs Department and the IRD to resolve this issue.

IRD will provide the Customs Department with the contact details of student loan borrowers and this information will be matched with arrival and departure information and supplied back to IRD. The cross referenced information will be used to determine if a borrower is eligible for the interest write off. Under the draft legislation the IRD will also be provided with the power to directly access arrival and departure information held by the New Zealand Customs Service. Without going into the exceptions, a borrower will be treated as absent from New Zealand if they are out of the country for 184 or more consecutive days.

To give non-resident borrowers who are likely to be identified by the data match a fresh chance to catch up on their obligations, the amnesty on student loan penalties for overseas borrowers is to be extended to 31 March 2008.

### NEW EMPLOYEE RELOCATION EXPENSES

In today's global employment market it is common for employees to be sourced nationally or even internationally. If an employee is not local to the business the recruitment negotiation will often result in the employer paying the employee's cost of relocation. This has been a contentious issue in the past as the IRD views the expenditure as income to the employee, and therefore should be subject to PAYE. The IRD position is in the process of being formalised; its position has been released in draft for comment.

The IRD has considered three situations:

1. Reimbursement from the employer of actual (or estimated) relocation costs
2. Direct payment by the employer of costs to a third party on account of the new employee

3. A lump sum payment to the new employee to cover all costs of relocation

The IRD has concluded that all three classes of payment are expenditure on account of an employee and therefore is part of the employee's income. The IRD's interpretation is based on case law that has concluded that relocation expenses are of a private nature.

The IRD has not covered the situation where the employer contracts directly with the relevant service providers used to relocate the employee. In this situation the argument would revolve around fringe benefit tax and whether or not the employee has received a benefit. It could be argued that since the employee is in the same position as before, although in a different location, no benefit has been provided.

From a strictly technical point of view the IRD's view is difficult to fault. However, from a practical point of view it does not seem appropriate for relocation expenses to be considered employee income. It is not expected that the IRD should turn a blind eye to this issue. But, given the Government's goal of trying to make New Zealand globally competitive and entice skilled workers to our shores, legislative amendment would be advantageous for employers. We hope that there will be more positive news on this issue in the future.

### GST AND HOMESTAYS ETC

It is well understood that the supply of residential accommodation is exempt from GST. This is legislated under the GST Act by section 14(1)(c), which provides that supplies of accommodation in any dwelling by way of hire, service occupancy agreement or licence to occupy are exempt from GST. The definition of dwelling is aimed at an individual's residence or abode, and excludes commercial dwellings.

Activities such as operating homestays, holiday homes, farmstays and serviced apartments don't fit completely within either category. However, the IRD has typically taken a practical approach in the past and allowed the activities to be GST registered where a continuous or regular activity exists. At present, input claims on the purchase of dwellings are accepted as long as the "principal purpose test" is met, i.e. the dwelling is used predominantly for the activity. This approach appears to have been abandoned in a 47 page discussion document that analyses the issue in detail. The document starts by saying it is "broadly consistent" with other statements by the Commissioner and then continues to state the previous policies that it is inconsistent with. In classic "neither confirm nor deny" style the document concludes that the facts of each particular case will decide if an activity is the supply of a dwelling or commercial dwelling. However, the tone and content of the document indicates that the IRD will initially take the view that the activities listed above do not qualify as taxable activities. Input claims in relation to the purchase of a building are likely to be disputed by the IRD unless the activity is 'substantial'. Some of the comments made by the IRD are outlined below.

In relation to holiday homes the IRD has the view that they are dwellings as their predominant function is to be a place of residence or abode. Holiday homes are considered to be too dissimilar to hotels and motels to be commercial dwellings.

Homestay or farmstay accommodation involves providing short term accommodation in a private home for a charge. The IRD views homestays and farmstays as clearly a dwelling, since the main function or purpose is to be a place of residence or abode. In addition the owners use the premises as their residence or abode. To be a commercial dwelling the IRD considers that a homestay operation would need to be run on a commercial basis with the

example of a boutique homestay cited. Factors relevant to this differentiation would include the commitment of time and money, the planning and projections undertaken, the prospect of making a profit, the research and marketing undertaken, and the suitability of the location.

A serviced apartment(s) or time share will be a dwelling unless it is a commercial dwelling. In the IRD's view a commercial dwelling provides accommodation for a number of unassociated people simultaneously. The commercial requirement may be met if a taxpayer has a significant number of serviced apartments.

We realise that tax law is far from black and white, but the IRD has taken an area in which a workable practice had developed over time and now has essentially changed its view and the rules we have to work by. Peter Dunne has indicated that if the document is finalised the GST Act will be amended to protect existing operators. However, the form of this protection is unknown at this point. We suggest that this is as much a protection for the government as the taxpayer, because if someone made an input claim on a property which is now time barred, then the property could be sold without accounting for the GST if the IRD doesn't consider that a taxable activity existed.

## LITTLE SNIPPETS

### Tax Bills Passed

In December Parliament passed the Taxation (Savings Investment and Miscellaneous Provisions) Bill and the Taxation (Annual Rates of Income Tax) Bill. The main focus of the former Bill above received considerable attention through the news media because it relates to the taxation of overseas share investments.

## International Tax Review

The policy advice division of the IRD released a discussion document in December 2006 that considers changing the way income derived from offshore interests is taxed. The Government is attempting to remove impediments to attracting and retaining business in New Zealand. Reform of this area was urged in many submissions on the Business Tax Review (released in July 2006) and it has been raised with government by a number of business groups.

At present if a New Zealand company operates offshore in most cases it will have to calculate its taxable income in the overseas country pursuant to that country's tax law. Then it would also have to calculate its income under New Zealand legislation, even though there may be little or no additional tax to pay. One option discussed is the introduction of a distinction between active (e.g. manufacturing or industrial) and passive (e.g. dividends, interest and royalties) types of income. The profits would either be taxed when repatriated to New Zealand, with a credit for foreign taxes paid or by allowing a permanent exemption for offshore active income. This type of regime would bring our tax system in line with that of other developed countries.

Lower non resident withholding tax rates for countries with which New Zealand has a double tax agreement are also being considered in order to reduce tax barriers to offshore investment. New Zealanders receiving payments sourced in countries with which New Zealand has a double tax agreement would enjoy lower rates of foreign withholding taxes.

## Bank Reconciliations

We would like to again remind those who run an accounting package such as MYOB to please make sure you do a bank reconciliation as at 31 March 2007, print the report and include it in the information you give us.

Often your bank statements will not be aligned to the end of the month (e.g. your bank statement end date is the 8<sup>th</sup> of April). If this is the case, please make sure you do a separate reconciliation up to the end of March before reconciling to your bank statement date.

Please pass this message on to your accounts staff if necessary and contact us if you have any queries about this.

## CONTACT US

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