

NEWSLETTER

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NEW LEGISLATION FOR MIXED-USE ASSETS

The Government has introduced a Bill into Parliament that will limit taxpayers' ability to claim a tax deduction for costs associated with mixed-use assets, i.e. assets that are used both privately and rented to third parties, for example baches and boats. When enacted, the new rules will apply from 1 April 2013. The new rules apply to an asset used partly to derive income and partly for private use if it is:



- not used for at least 62 days in an income year,
- is land or an asset with a cost of more than \$50,000,
- held by an individual, partnership, trust or close company, and
- not a motor vehicle, or an asset whose expenditure is apportioned for tax purposes on the basis of floor area, etc.

"Private use" is defined as use by the owner or an associated person or use by a third party for less than market value. Broadly there are three categories of costs:

1. costs that provide a solely private benefit that are not deductible,
2. costs that provide a solely income earning benefit that are deductible, and
3. the balance that is apportioned between the period the asset is used to derive income and the period it is used privately, as per the formula below:

$$\text{expenditure} \times \frac{\text{income-earning days}}{(\text{income-earning days} + \text{private days})}$$

Income earning days are defined as the days in which the asset earns a market value rate of income or above. All other days the asset is in active use are classed as private days (i.e. when the asset is in use

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by the owner or if it is rented out at below market rate). For example, if a taxpayer's holiday home is rented for five weeks and used privately for five weeks then the costs, which provide neither a wholly private or income earning benefit, are 50% deductible.

Additional complexity does exist as there are specific rules around the apportionment of interest costs on borrowing and GST.

Losses are unable to be offset against other income and are instead offset against future income from the asset, if the gross income derived from renting the asset to non-associated third parties is less than 2% of:

- in the case of land, the latter of either the most recent rating valuation or cost at acquisition, or
- for other property, the cost of the asset to the taxpayer.

Taxpayers will also have the ability to opt out of the rules if the income from an asset is less than \$1,000 in an income year. If a person opts out of the rules the income is treated as exempt income and not subject to tax.

With 1 April 2013 not so far away, it would be prudent to think about how these rules may apply to any mixed-use assets you own and what record keeping processes you may need to introduce.

THE LEADERSHIP CHALLENGE

There are often good intentions behind New Year's resolutions; lose weight, improve work-life balance and be more successful. However, life has a funny way of upsetting the best laid plans and it is the same in business where the new norm is to expect the unexpected. This presents a challenge for leaders.



talented people want to work for collaborative leaders who inspire and challenge them.

The leadership challenge is to coordinate and balance the changing and sometimes conflicting needs of all stakeholders including staff. This will involve constantly monitoring and adjusting the way business is done whilst managing risk.

If you are in business then you will intuitively know that leaders perform better when they have broad-based skills, including communication and relationship building. Using this as a base, leaders can build and maintain strong relationships with stakeholders such as key clients and staff. Richard Branson recently advocated thinking about every customer you have, whether that's one or one million, as individuals and treating them as such.

Treating people as individuals extends to your staff. Having a well articulated and clear vision will galvanise employees into action and both retain and attract top talent. Taking that further, the leader needs to be the role model for how things are done in the workplace. They must ensure that staff have the information, knowledge and methods available to realise the vision. Enlightened employers know that

Sir Winston Churchill once said "Success is not final, failure is not fatal: It is the courage to continue that counts". But unlike management, which can be taught, leadership comes from within. So at a time when leaders should expect the unexpected, now is the perfect time for a leader to buddy with a credible coach or mentor. Business coaching is now a profession and you can find a coach by searching the internet or requesting information from the International Coaching Federation for the Australasian Region, or talking to other business leaders about who they use. These professionals can enhance a leader's personal learning and help deal with challenges that arise. So perhaps this year the New Year's resolution should include 'get a coach'?

TAX TREATMENT OF EMPLOYEE ALLOWANCES

In an effort to reduce uncertainty regarding the tax treatment of employee reimbursements and payments for meals, accommodation, communication and clothing, the IRD released an officials' issues paper in November 2012. The IRD is seeking feedback on proposals to introduce legislation specifically pertaining to these types of expenditure.

MEALS

- **Employee meal costs when travelling for work** - tax-free if duration of travel to a given location is less than three months, otherwise taxable in full for longer trips,

- **Meal expenses (not during travel for work)** - tax-free provided payments are not made on a regular basis or as a reward for employee services.

ACCOMMODATION

- **Cost of employee accommodation when travelling for work** - tax-free if duration of work travel to a particular work location is less than 12 months, with a



discretion for travel in excess of 12 months in exceptional circumstances - taxable in full for longer trips,

- **Cost of accommodation provided as part of employment, e.g. farmhouse** - No change - the market value of accommodation to be treated as taxable,
- **Employees who work from home** - No change - market value of accommodation is taxable,
- **Cost of accommodation (more than one permanent workplace)** - Factual assessment of the principal place of work to be performed i.e. based on time spent. Accommodation payments for the second workplace may be tax-exempt,
- **Cost of accommodation (employees seconded overseas)** - Treat as taxable up to the market value of equivalent accommodation in NZ, e.g. a similar property with the same number of bedrooms.

COMMUNICATION

- **Payment for employee's communication costs (including telephone and internet)** - Taxable in full except where the private/work portion is able to be separately identified.

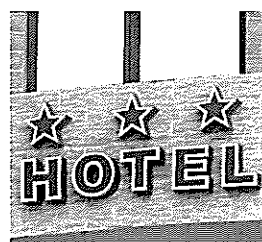
CLOTHING

- **Cost of clothing for employees** - Taxable unless the clothing is necessary and peculiar to the employee's occupation e.g. uniforms, protective or specialist clothing.

On a related topic, in December 2012 the IRD released a statement (CS 12/01) that has caused some concern. The statement outlines the IRD's view on accommodation allowances and accommodation provided to an employee on secondment when that employee continues to maintain a home in their original location. In this situation it is accepted practice for such expenditure to be treated as non-taxable to

the employee. This treatment and its approval by the IRD dates back to the now expired (in 1998) Technical Rulings Manual, which included the following statement:

57.11.1.1 Exemption - Cases will arise where an employee is required to live away from his/her normal place of residence. He/she is required to maintain the normal place of residence for the family while working away from home. In these cases, there will be no



benefit in respect of the accommodation supplied by the employer as the cost of maintaining the family home will offset any benefit received. The value of the accommodation supplied will not be taxed.

In contradiction to its own historical commentary, the IRD have now advised:

- Where an employer provides accommodation or an accommodation allowance, the amount is taxable and subject to PAYE,
- When accommodation payments have been made by the employer for expenditure incurred by the employee the amount is taxable and subject to PAYE,
- Accommodation for overnight and short-term stays by an employee in another location is not taxable.

The statement has been poorly received as the IRD's view is arguable, however due to the lack of technical analysis provided, it is difficult to confirm how the IRD has reached its view. The IRD have advised that taxpayers should make a voluntary disclosure if they have not treated amounts correctly. For this purpose the statement should be referred to as the period of reassessment, and application of interest and penalties will vary depending on the facts.

HOW MUCH TO CHARGE?

One of the most difficult decisions to make as a business owner is how much to charge for your products. There is often a reluctance to review pricing because of the fear of upsetting existing customers or due to a lack of time. However, there are a number of actions you can take to make your pricing process smoother and more robust, ensuring that your pricing is correct for you and your customers. The following framework provides practical instructions on how to review your pricing.



- Refer back to your business plan to confirm how you were planning to position your products in the market, and whether your current pricing is consistent with that plan. If you don't have a business plan, create one.
- Consider what you're trying to accomplish with your pricing. Pricing can send a direct message to your customers regarding who you are as a business and the type of products you offer. For example:
 - Customers can assume, rightly or wrongly, that more expensive products are better quality than cheaper alternatives,
 - Customers also tend to resist products they see as too highly priced; however, they also resist

cheaply priced products because they assume they are low quality.

- Consider how prices will affect demand and seek active feedback from your customers, including how they value your products.
- Consider the needs of customers and the value they place on your products. This can be a major pit-fall in pricing because customers may be willing to pay more than you realise. Customers who are unhappy with pricing on the other hand will generally let a business know how they feel, or they just won't purchase the products.
- Consider your competitor's pricing and any perceived or real difference in value provided. This is to ensure that the business is making as much as it can and also that you are not being priced out of a market.

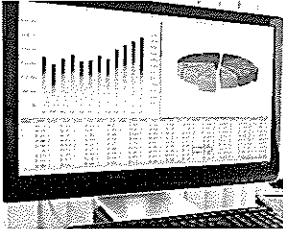
- Consult with a business advisor. They will have a wider understanding of what is happening in the marketplace and can help guide you through pricing decisions.
- As a general rule you should review your pricing at least annually. This is to ensure that pricing is still consistent with industry best practice and that you are getting all that you can out of your business.

The reality is that incorrect pricing can seriously undermine business performance. In a changing business landscape customer's ideas on value can change rapidly. Businesses therefore have to be more responsive and proactive in their pricing to ensure that products are priced appropriately.

SNIPPETS

TAX STATISTICS

The IRD publishes statistics on its website that provide an interesting picture of New Zealand's tax profile. The data is updated annually (most recently updated in December 2012) and this is the fourth year it has been available to the public. Some observations based on the latest data are below:



- The data shows an increase in revenue collected from GST and company tax in recent years, compared to individual tax and other duties such as customs, estate, approved issuer levy, etc,
- The percentage of resident student loan borrowers who meet their repayment obligations is now at an all time high of 97%,
- Overdue debt is increasing and has been on an upward trend for at least 10 years. A significant portion of this is made up of overdue income tax, GST and child support,
- The number of families receiving Working for Families tax credits has been increasing. However, the average entitlement received per family has decreased slightly,
- Close to 82% of customers/taxpayers surveyed say the IRD is easy to access, although only 66% think that the IRD do enough to inform customers of their rights and obligations.

The statistics can be found on the IRD's website at <http://www.ird.govt.nz/aboutir/external-stats/>.

HOW DO YOUR EMPLOYEES SPEND THEIR DAY?

A review by a US infrastructure company of its remote login records showed a regular pattern of logins were occurring from a location in China. After further investigation what was initially thought of as a malware issue was in fact the login activity of a subcontractor hired by an employee to do his work for him. The employee was paying the contractor a fifth of his six figure salary and submitting the contractor's work as his own. Study of the employee's computer habits revealed his typical work day consisted of:

9:00 am – Arriving and surfing Reddit for a couple of hours, then watching cat videos

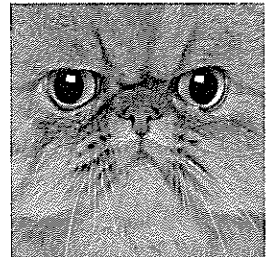
11:30 am – Lunch

1:00 pm – Surfing Ebay

2:00 pm – Surfing Facebook and LinkedIn

4:30 pm – Sending an end-of-day update email to management

5:00 pm – Go home



He was a longstanding employee who from the firm's perspective was a top performer. Further evidence suggests he took jobs with other firms and outsourced that work as well.

It's a matter of personal preference on the part of employers' whether the lesson here is too much employee discretion can be a bad thing or whether money can be saved by contracting employee roles out to cheaper suppliers...it's not known whether the US company ended up contracting directly with the Chinese contractor.

If you have any questions about the newsletter items, please contact me, I am here to help

CLAIM FOR TAX EXEMPTION UNDER MAORI LAW

It is considered settled law that a New Zealand resident is subject to New Zealand's tax laws, irrespective of gender, race or religion. As stated by Hillyer J in *Kaihau v IRD* (1990):

"...it is abundantly clear that the New Zealand Parliament has the right to enact legislation applying to all persons in New Zealand, whether they had ancestors who lived here in 1840 or whether they have only recently arrived in New Zealand."

In TRA Case 9/2012 a taxpayer recently claimed to be exempt from tax under Maori law or Maori sovereignty. The case involved a company that operated a business providing shearing services to farmers, mainly in the Southland region. From January 2005, the taxpayer failed to deduct and account for PAYE on wages paid to its shearers and shed-hands. The taxpayer claimed they were not able to be taxed by the IRD as the taxpayer was subject only to Maori law and not the laws of Parliament.

The IRD was initially alerted to the situation by an anonymous caller who advised that the taxpayer was deducting a 21% "charitable tax" from payments made to workers. The taxpayer stated that this charitable tax went to Maori community purposes.

The IRD commenced an investigation and determined the taxpayer was liable to withhold tax, either PAYE (if the workers were employees) or withholding tax (if the workers were contractors). The total tax due, including a penalty for tax evasion, was \$1.6m. During a meeting with the company's director it was argued that no tax is payable under the Maori Land Act. The IRD advised that the Maori Land Act was irrelevant because that Act was about promoting the retention of Maori lands in the hands of its owners and their whanau, not income tax.

Later during the formal disputes process, the taxpayer produced as evidence a document called "Notice of Understanding and Intent and Claim of Right" under which it argued that Parliament is bound by the Maori Land Act, which allows the Maori people to set up their own judicial jurisdiction and operate within it. It stated the taxpayer had a right to claim money from the Commissioner, under its fee schedule, if its members are questioned or property interfered with – damages of \$8m were later claimed.

Through Notices of Claim submitted to the TRA, the taxpayer claimed that it was subject to Maori law or Maori sovereignty, and was exempt from being taxed by the IRD. The taxpayer claimed that it was exempt from all income tax, and that the IRD was guilty of abuse of process, breach of fiduciary duties, abuse of power, constructive fraud, discrimination etc. The judge was asked to either apologise or step down as he would not accept Maori sovereignty in the case, and would not allow the case to be heard on a Marae.

The TRA Judge summed up the taxpayers claim by stating that it "was rather confusing and focuses on the pleading that the Adjudication unit, this tax review tribunal and the High Court have no jurisdiction to rule on matters of Tikanga Maori". The taxpayer's Notice of Claim was struck out. Leave was granted to enable the taxpayer to pursue the argument that the shed-hands and shearers were independent contractors (thus reducing the tax owed), or to dispute the evasion penalty. The taxpayer did not respond within the allocated time.