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Client Newsletter

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Changes from 1 April 2012

The new tax year will bring a number of changes across both tax and social policy. Some of these are below:

Student Loan

Where employees have a student loan, they must add "SL" to their tax code unless they have an exemption. An employee may be exempt from making student loan repayments if they're studying full time and expect to earn less than \$367 a week or \$19,084 (the annual repayment threshold) in the tax year.

They will need to give their employer a certificate authorising a repayment exemption. The "SL" repayment code is not needed while the exemption applies.

Employer Superannuation Contribution Tax

The 2% exemption from employer superannuation contribution tax (ESCT) no longer applies from 1 April 2012.

If an employer is contributing to a KiwiSaver scheme or a complying fund, all their employer cash contributions will be liable for ESCT. The rate for calculating ESCT will change from 1 April 2012. The 33% flat rate option can only be used if contributions are paid into a defined benefit fund. Otherwise ESCT needs to be calculated at the employee's marginal ESCT rate. Alternatively, the employer cash contributions can be treated as salary or wages and the employee can be taxed through PAYE (with their agreement).

Gifts and Entertainment

Employers often confuse the tax treatment of gifts and entertainment expenses. As a result, we commonly see 50% of all gifts and entertainment being treated as non-deductible entertainment.

Usually when one incurs staff or client expenditure, they are treated in two ways – either as fully deductible entertainment or 50% deductible entertainment.

Fully deductible entertainment, usually associated with staff expenditure, may attract a fringe benefit tax (FBT). Whether FBT applies or not will depend on whether the value of the benefits provided during the year (or quarter) exceeds the FBT exemptions available to employers (refer to our December/January 2011 Client Newsletter).

50% deductible entertainment is more common with customer expenses such as client lunch at a restaurant, whether it is a business or social lunch. Similarly, staff drinks and shouts, in or away from the office, are also 50% deductible.

However, one has to distinguish gifts from entertainment. The IRD generally allows a 100% claim on gifts to clients such as a bottle of wine, box of chocolates, bunch of flowers, tickets to a movie/concert etc. Then again, a blanket treatment cannot be used with certain gifts – this is best illustrated by way of an example below.

If you buy tickets to say a rugby game for your client where the seats are available to the general public, including front row tickets, the cost will be fully deductible.

But if you give tickets to your clients for a corporate box or invite them to enjoy your hospitality at a set-up marquee or tent or a corporate box, the cost will only be 50% deductible.

Gifts to staff are also fully deductible but they may be caught under the FBT regime.

As can be seen from above, the tax treatment of gifts and entertainment is not as straight-forward as it may seem because of the potential overlapping of the FBT and Entertainment tax regimes. If you are in doubt as to what deductions you can claim, we suggest you contact your tax advisor.

Business Builders • Business Accounting • Farm Accounting

Overseas Companies and Audit Requirements

Until recently, overseas companies were required to file audited financial statements with the Companies Office. The requirement has been modified slightly to those overseas companies that are "large".

Large is defined as crossing any two of the following criteria:

- NZ\$20,000,000 in annual turnover (as per statement of financial performance shown in their latest financial accounts).
- NZ\$10,000,000 in a company's assets (as per statement of financial position shown in their latest financial accounts).
- 50 or more full-time employees (includes employees in subsidiary companies) (usually not reflected on the financial accounts).

Small Block Farms

Small block farms, often referred to as lifestyle blocks, have remained a long standing topical issue in New Zealand. Whether it is purchased with a view to operating a proper business or to simply live on an extensive section while carrying on some business activities, taxpayers seem very keen on claiming whatever expenses they can as taxable deductions to reduce their personal taxable income.

However, the Inland Revenue has and will always argue that it is a lifestyle block purchased solely for domestic purposes if the facts of the case are so grey as to indicate that it had nothing to do with any business venture.

This may pose a huge problem where there is a genuine intention to run the small block as a business which has incurred losses in the initial years, as would be normal, and the Inland Revenue questions the very existence of it as a business!

Thus, it is absolutely important to establish that the taxpayer intended to run the small block as a business.

The definition of business is not exhaustive in the Income Tax Act and therefore reliance is placed on case law to support the existence of a business, the leading case being *Grieve v Commissioner of Inland Revenue* (1983) 6 TRNZ 471.

The courts set out a number of conditions, stated below, to determine whether the farming activity constituted a business. These include:

- the nature of the activity;
- the scale of operations and the volume of transactions;
- the commitment of time, money and effort;
- the period of time over which the taxpayer engages in the activity;
- the pattern of activity;
- the statements of intentions made by the taxpayer;
- whether the activity carried on is of the same kind and manner as any other profitable farming operation would be expected to carry on;
- the financial outcome.

In conclusion, it can be said that fundamental to establishing it as a business activity for tax purposes is the taxpayer's decision in the first instance – whether his lifestyle block is going to be a business or a hobby. Once his intention is established, the above guidelines, set out clearly by the courts, should be used to support his business activity.

Allowable Deductions

Once it is determined that the lifestyle block is purchased for a farming business, all business-related expenses will be deductible.

However, care needs to be taken when funds are borrowed as the Inland Revenue Department may not allow a claim for the full mortgage interest. The premise is that the dwelling house sitting on this small block is of a private nature and any interest paid on the mortgage will have to be apportioned between the private dwelling house and the land and buildings used for the business. The apportionment is allocated on the basis of the values for the house and the business assets. Even if the taxpayer's down payment fully covers the value of the private dwelling house and the mortgage is raised for the farming land, the Inland Revenue Department may still insist on splitting the interest charge and allow a deduction for the portion related to the business only. It is best to contact your advisor if you are contemplating buying your lifestyle block.

Important: This is not advice. Clients should not act solely on the basis of the material contained in the Client Newsletter. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Client Newsletter is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval. 188/2011.