



Looking out across the Waikato
from the KaiMaui Ranges

NEWSLETTER

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BUDGET 2012

The Government's Budget was announced on 24 May 2012. Compared to previous years, there are few, if any, changes impacting business. Some of the changes that have been made are outlined below.

MIXED-USE ASSETS

The term 'mixed-use assets' is used to describe assets that are used for both private and business purposes. The classic example is the kiwi bach, which might be used for only a few weeks during the year, but available for rent during the rest of the year. Under the current rules, tax deductions can be claimed for the period a mixed-use asset is available to derive income, regardless of whether it actually derives any income. Going forward, tax deductions will be based on how much an asset is actually used personally versus its use to derive income.



TAX CREDITS

Three tax credits have been removed as they were seen as "outdated" and no longer serving their original policy intent. They are the tax credits for:

- **Income under \$9,880** – this was introduced in 1986 to ensure low paid full-time workers were not worse off due to tax reforms. A taxpayer earning less than \$9,880 could claim the tax credit for every week they were in paid work for 20 hours or more.
- **Childcare and housekeeper tax credit** – this credit (of up to \$310) was first introduced in 1933 and last revised in the 1984/1985 tax year. Since then Government support programmes such as Working for Families and free early childhood education have been introduced.
- **Tax credit for active income of children** – this was introduced in 1978. The policy intent was to reduce the compliance cost for employing children part-time. The tax credit meant that employers of

children on low annual salaries did not need to withhold tax i.e. PAYE. This will be replaced by a limited tax exemption for income not taxed through the employer's PAYE process.

The tax credits will be repealed from the 2012 - 2013 income year. Taxpayers will still be able to claim them for the 2011 - 2012 income year.

LIVESTOCK VALUATION RULES

A further notable change is to the livestock valuation rules. The livestock regime caters for the fact that some farmers might hold stock on capital account versus other farmers who might hold stock for resale (or both). The purpose for which a farmer holds

livestock was intended to determine which valuation method is to be used, as that determined how increases and decreases in stock values are taxed. However, under the current rules farmers are able to switch methods causing a disconnect between the purpose for owning the livestock and the tax outcome. This was not intended and the rules have been tightened to restrict switching between valuation methods.

Whether the budget reflects a "steady as she goes" approach to provide certainty in uncertain economic times or a budget produced by a Government with a lack of inspirational vision is a matter of opinion.

REPAIRS AND MAINTENANCE EXPENDITURE: IS IT CAPITAL OR REVENUE?

The phrase "repairs and maintenance" ("R&M") is typically used to refer to costs for repairing, altering or maintaining a capital asset. These costs are immediately deductible if they are revenue in nature and not subject to the capital limitation. In practice it can be difficult to determine whether costs are of a capital or revenue nature, as there is no succinct legislated provision to be "ticked off". Instead, the question is answered with reference to a considerable body of case law and the specific facts in a given scenario.



In June this year, the IRD finalised its Interpretation Statement (IS 12/03) setting out its view on what it considers the general principles for determining whether expenditure qualifies as R&M. The statement has replaced previous commentary issued by the IRD. Although the IRD's view has not changed in any substantial way, the latest statement is 55 pages, compared to the previous five page statement released in 1994.

Broadly, a two step process is used to determine whether expenditure is R&M. Firstly, the relevant asset is identified. Secondly, the nature and extent of the work is considered in the context of that asset.

As a general rule, if work carried out on an asset results in the reconstruction, replacement or renewal

of the asset or substantially the whole of the asset, the cost of that work will not qualify as R&M. However, costs to repair or maintain an asset, or restore an asset to its original condition, without going so far as to reconstruct, replace or renew it, will qualify as R&M and will be deductible.

The line between restoration of an asset versus its renewal can be difficult to identify and one of the examples provided by the IRD is of concern. Example 23 of the Interpretation Statement involves a residential rental property in a good state of repair that was damaged in an earthquake. To get it back to a tenable state the foundations are replaced, the floors reconstructed and three external walls are rebuilt and the roof replaced. The IRD considers the costs would be capital in nature as the work results in the "effective renewal" of the asset. However, case law provides strong support for this work being revenue in nature and therefore R&M. That case law suggests the work is to repair something that previously existed, it is not to produce something new, it does not significantly improve the asset or make it different in kind by changing its character, and thus does not increase its value or extend its useful life. It does no more than restore it to its original condition and should therefore qualify as R&M.

The Interpretation Statement sets out the IRD's current view and therefore reflects the view that can be expected to be taken by the IRD's investigators. Unfortunately, it is a matter of opinion, not fact, as to whether it is correct.

PAYMENT TERMS & OPTIONS

With over 25 years of experience in providing professional and personal services to all of our clients we are well aware of the difficulties, hardships and pressures the current economic environment has brought.

During these times it is essential that terms of trade and payment terms are set and applied. We pride ourselves on following best business practices and this year will be implementing a firmer approach to our debtor management processes than you may

have experienced in the past. Please do not be offended if you are contacted by one of our accounts receivable team, who will be putting these processes into effect and administering our current payment terms.

Our payment terms are set out in the terms of agreement and we are happy to send you a copy of those if you require a copy.

Penalty interest will be incurred once an account is overdue by 30 days at a rate of 20% per month (including GST).

PAYROLL – HELP WANTED!!!

An organisation's payroll function can be a confusing and time consuming task, but there are a range of options available that can help. Rather than battling away in isolation, an organisation could consider acquiring an appropriate software package, using a third party payroll contractor or outsourcing the payroll function to an internet-based provider. Choosing the right option will inevitably be a case of balancing the cost of each option against the advantages to be gained. The main options are outlined below.



PAYROLL SOFTWARE

Many employers use payroll software purchased from a third-party supplier. The software is designed to assist the user with processing payroll information, producing an employee's payslips, IRD schedules and management reports. Some systems are able to be integrated with the organisation's primary accounting system. This allows the payroll transactions (e.g. wage and PAYE payments, month end journals and employee provisions) to be updated to the general ledger on a weekly or monthly basis.

These software systems, once set up with the required deductions and calculations, can efficiently produce the required information for each pay-run. Where an employer has only salaried staff, this information can be produced with minimal time and effort as the same information is generally used for each pay-run, with only staff changes and leave information required to be input into the system.

Payroll software usually requires an initial software licence to be purchased, and an ongoing annual fee for upgrades as required. The charges for this will vary depending on the software provider. Some providers offer a free trial system that can be downloaded from their website so users can try before buying.

We understand the importance of supporting our clients by providing options and in order to assist you in adhering to our payment terms we have various payment solutions to suit your needs such as:

- direct credit to our bank account,
- cheque,
- monthly payment options via FeeSmart.

If you would like to find out more about our payment options via FeeSmart, please contact our office to discuss what solution will work for you.

While these software programs are regularly updated in line with changes in legislation, the employer will still need to have a payroll administrator who keeps up to date with legislative changes.

OUTSOURCING

Employers who have a large number of employees that are paid on an hourly basis, or who simply don't have the resources to complete their payroll themselves, may wish to consider outsourcing their payroll process or acquiring the services of a payroll contractor.

Internet-Based - using an internet-based provider, timesheet information is either input by the employer or sent through in a raw form to be processed. The provider can generally:

- produce and distribute payslips,
- produce and file PAYE schedules,
- withdraw funds from the employer's bank account and make payroll and PAYE payments directly, and
- maintain records such as annual leave, sick leave and other entitlements.

The employer can access their payroll information remotely through the provider's website removing the need for the employer to install, maintain and administer the payroll system. Some systems also allow employees to log on and print out payslips as and when required.

Payroll Contractors - for those employers who prefer a more traditional approach, similar services can be obtained by acquiring the services of a payroll contractor. As with an internet-based provider, the information (such as timesheet and employee information) can be processed either by the employer or the contractor. Typically, the contractor will use the employer's payroll system, in which case the employer would still incur the cost of maintaining that system.

With either option there should be a reduction in the workload associated with the payroll process and the requirement for payroll staff to keep up to date with current payroll-related legislation.

Outsourcing the payroll function will come at a cost, but the cost could be outweighed by the time saved, and peace of mind knowing that the organisation's legal and tax obligations are being looked after.

SNIPPETS

WORKING FOR FAMILIES – WHAT'S YOUR INCOME?

Entitlement to Working for Families (WFF) payments is based on a family's income, which is calculated using very specific rules. These rules have undergone a number of changes over the past few years to close potential loopholes and make the system fairer. The need to calculate the 'income' amount correctly was recently highlighted in a decision by the Taxation Review Authority (TRA).

The decision of *X v CIR* involved a couple who owned five rental properties that incurred losses. These losses were included in the calculation, which reduced the taxpayer's 'income' for WFF purposes



and increased their entitlement. At issue was whether or not the activity constituted a business, in which case the losses are ignored.

The IRD disputed the income calculation and took the view that the rental activities of the partnership constituted a business and therefore their income should not be reduced by the losses. The taxpayers argued that they only ever intended to make capital gains from the properties, and therefore their rental activities were not a business. They were unsuccessful and the TRA upheld the IRD's view.

The case is a timely reminder that income for WFF purposes needs to be calculated correctly, especially given the recent changes.

PUSHING THE LIMITS ON TAX DEDUCTIONS

Many taxpayers try to come up with creative or unusual reasons as to why purchases should be considered legitimate business expenses. Here are a few from the US:

- A woman in Arizona attempted to deduct \$26,000 relating to nappies, food, clothes, pictures and a nanny because she used an image of her child in her logo for her curtain and blinds business. While she wasn't allowed a full deduction, she was allowed a deduction for the photographer costs, clothing and stroller that carried the company logo.
- A taxpayer refused to use a computer or telephone because of his distrust in technology. He instead used carrier pigeons to communicate with his business partner, and was allowed a deduction for the costs of caring for the pigeons.
- A junk yard owner in South Carolina used wild cats to rid his property of snakes and rats. He put out cat food to attract the wild cats which then ate the rats and snakes. A deduction was allowed for the cost of cat food.



While these taxpayers obtained deductions for unusual items, it is important for New Zealand taxpayers to remember that there must be a sufficient connection between the expense and the taxpayer's income earning activity in order to claim a deduction.....without getting too creative.

If you have any questions about the newsletter items, please contact us, we are here to help