

# NEWSLETTER

May/June 2002

## FBT ISSUES

### Cellphones

Cellphones are now a fashion accessory! If you provide cellphones to employees then your staff may have an FBT accessory as well.

Cellphones can attract FBT if the employee can use the cellphone to make private calls. Recently there have been cases of IRD staff going through cellphone accounts. The key question is: *How much does the employee use the phone?* If the cellphone accounts are large, which they may be for some executives or sales people you may have an issue.

One way to minimise the risk is to put a restriction on private use in the individual's employment contract or company policy. This has the effect of reducing the business' liability if they are ever questioned by the IRD and may save you penalties if you are found to have a FBT liability

Generally there is no FBT on benefits provided to employees on your premises. Private calls made by employees from an office phone will not be subject to FBT.

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## Is your Home your Workplace?

For many businesses home is also a place of work. You may have a substantial office in your house and manage aspects of your business from home. The extent of your home office is going to affect the FBT paid by your company.

If you are running your business through a company you are probably also a shareholder-employee\* of that company and driving a company car. The company must pay FBT on any fringe benefits you enjoy. This will include the company car.

If your home is also your workplace then on workdays when you drive your company car to visit clients or suppliers you are travelling from your home-based work office to another work site. This is work to work travel. There is no private travel element and no fringe benefit.

Conversely, if you do not use a home office and have an office at separate business premises, your travel from home to your office, clients or suppliers, will be regarded as private travel. This is home to work travel. You have enjoyed a fringe benefit. The company will be accountable for FBT on each day that you drive the company car from home to your business premises as the car was made available for your private use.

The IRD has released a draft statement setting out guidelines to help you work out whether your home is a work base. You may be able to use these guidelines to reduce the FBT payable for

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\*Shareholder-employee - someone entitled to receive a salary, regardless of whether or not a salary is allocated in a particular year.

employees who do significant work from home, e.g. sales and technical reps.

If you would like us to consider your business facts in the light of the IRD's statement, please give us a call.

### **FBT Interest Rate Change**

The rate of interest used to calculate low-interest, employment related loans has reduced from 7.19% to 6.70% effective 1 January 2002.

### **GST and FBT**

GST on Fringe Benefits is calculated on the taxable value of the fringe benefit provided to the employee, not on the amount of FBT paid. This is a common error and results in GST underpaid by about 50% in most instances.

If you would like any assistance with FBT returns, please give us a call.

## **ITEMS OF INTEREST**

### **Employee Share Schemes**

Employee share schemes are an attractive way to motivate high performing employees and retain key staff. Before you embark on an employee share scheme, a number of tax and business planning issues need consideration. You must ensure that staff understand the consequences of joining the scheme.

Employees are taxable on the gap between the issue price of the shares and their market value. The tax on the gap is payable whether or not the employee has sold the shares. Any rise or fall in the share value after issue will not be taxable or deductible.

Options are the right to buy shares at a fixed ('strike') price at a date in the future. The tax treatment of options is similar. The employee is taxable on the difference between the market price and the strike price at the time of the share transfer.

Call us before you consider implementing a scheme. We can advise on the benefits, pitfalls, tax considerations and your other options.

### **Tax Changes for Charities**

During 2001 the government debated the treatment of charities – both from a tax perspective and a wider administrative view.

The changes recommended include:

- A new Charities Commission to oversee the registration, monitoring and reporting requirements for charities.
- Registration of charities with the Charities Commission to obtain and keep their tax-free status.
- Annual review by the Charities Commission of each registered charity's on-going qualification for charity status exemption.
- Changes to the superannuation schemes run by charities. Historically these schemes were used to give tax-efficient rewards to employees on below market salaries.
- A tidy up of the rules on GST input credits for charities.
- A slight increase to the donations rebates for individuals and companies.

### **A Touchy Topic!**

Summarising your cashbook at financial year end ready for the accountant can provide some useful insights. Money comes in, money goes out. If you are a successful money manager you will know where your cash has gone.

Even the most successful business people can find controls on private spending difficult to manage, especially when there is no fixed income. Drawings are a sensitive topic. Frequently we see business bank accounts used as a slush fund for business and personal needs. This makes it difficult for you to keep a month by month watch on

personal spending. You may not be aware of your level of drawings until the end of the year, when your accounts are finished and a detailed listing is available. That high private spending can be a nasty surprise!

*What can you do about it?* Your household cash position will be clearer if you run a separate personal account and transfer a fixed monthly amount from your business account to cover your living expenses. Agree on a figure with your family and know that is your spending limit. If the personal account runs low, you can always make an additional transfer to cover more private spending.

With this system you can check on a monthly basis whether your household is living within its means. This technique won't stop you spending but it will give you an early picture of what you are doing.

### **Qualifying Companies**

The qualifying company regime grants to electing companies special status. Loss Attributing Qualifying Companies can pass losses through to shareholders, who can, in turn, offset these against other income, similar to a partnership structure. Qualifying Companies can also distribute capital gains to shareholders tax free.

The regime is administered by the IRD and has strict criteria limiting the types of companies that can go into and remain in the regime. A new company wishing to enter the regime must complete an election form and forward it to the IRD before the last date for filing its first tax return.

If you are interested in entering the qualifying company regime or would like to understand if it would provide you with any additional benefit give us a call. We can prepare the paperwork and organise the timing of lodgement. For those within the scheme new election paperwork must also be filed with the IRD each time shares change hands. Please ensure that you advise us of any changes.

## Was that Spending Capital or Revenue?

The capital/revenue spending area is a frequent focus for IRD audits. We try to anticipate the IRD's questions by asking you for more information when we work on your annual financial statements and tax returns. We ask:

- What did you actually buy?
- Did you create something new?
- Define the asset?
- Was the work intended to improve an existing asset or simply restore it to working order?

These questions are directed at answering the question: Is the expenditure capital, and possibly subject to depreciation or revenue and immediately deductible?

Your answers will contribute to the capital or revenue decision. At its simplest we are trying to establish whether the "expenditure brought an asset into existence for the enduring benefit of the business".

If you are not sure whether spending is capital or revenue, seek advice when the expenditure occurs. That way you will ensure the correct tax position is shown in your accounts.

## Loans to Friends and Family

Businesses that borrow money from, or lend to, friends and family will show these amounts on their balance sheet. These loans are often on friendly terms.

We are encouraging clients to ensure that these loans are documented. This establishes the terms and conditions of the loan including: repayment amounts and frequency, the right to receive/demand interest, the interest rate and the negotiability or assignability of the loan.

Undocumented loans can be scrutinised and the IRD may decide that a market rate of interest should apply retrospectively.

Undocumented loans are also at risk from another direction. If the loan is not repaid after the passage of time, it may be that repayment was not intended. The loan may be regarded as 'forgiven'.

The IRD can treat the forgiven loan as income to the borrower, with resulting tax to pay. Alternatively, the loan principal and possibly any interest forgone may be considered a gift by the lender with gift duty consequences.

Conflicts can also arise in matrimonial situations. A separated partner can argue that it was never intended that a particular family loan was repaid and that the value of the loan is part of the matrimonial property available for division.

These costs and uncertainties can be avoided by straightforward redocumenting to refresh the loan, ensure its continuity and minimise risk.

## Did you Know?

- ACC is deductible for income tax and claimable for GST when it is due and payable. If you pay your ACC account before it is due you must hold claiming the deduction until the due date.
- Not all sickness, accident and loss of earnings policy premiums are deductible as a business expense. It depends on the policy terms and whether any payout is linked to your business profits. Call us to check. The treatment of any payout is usually symmetrical: premium deductible, payout is taxable; premium non-deductible, payout is non-taxable.
- If you are GST registered and receive a donation or grant from a government agency, you must return 1/9th for GST. By contrast, donations or grants from charitable organisations are usually unconditional gifts. If the giver receives no direct, identifiable, valuable benefit in exchange for the gift, no GST is payable by the recipient of the donation.

## NEWS AND UPDATES

### Welcome Penalty Change

A new penalty rule will be kinder to tardy taxpayers. Under the old rule 5% was added to your account if you were one day late. You will now be charged 1% if you are a day late and, providing you pay within 7 days, there will be no more penalties. If you don't pay after 7 days you will be charged an additional 4%. Use of money interest will continue to apply to all of the debt.



### New Sharemilking Agreements Order

Most dairy farmers will be aware that a new Sharemilking Agreement Order came into force last year. The objective of the Order was to establish minimum terms and conditions for inclusion in Lower Order Sharemilking Agreements where the milker does not "own" the herd.

The Order affects remuneration. For herds of 300 or fewer cows the milker must receive no less than 21% of the projected milk income after allowing for the sharemilker's projected farm operating expenses. In larger herd situations, the share of milk proceeds is open to negotiation.

Two key issues that are not dealt with in the basic agreement are:

- whether any end of season adjustment should be made once actual income and expenditure are known
- the costs covered by the phrase "farm operating expenses"

If you are involved in negotiating a Lower Order Agreement we recommend that you consider:

- whether a look back provision should be included and its timing
- any restrictions on the sharemilker's expenditure
- detailing the farm operating expenses

Discussion on the terms of the agreement will help maintain good

communication. The Order suggests that both parties seek independent advice before signing. Why not make it a requirement that parties seek independent advice? If one party elects not to obtain professional help, a waiver should be signed acknowledging they opted to forgo this right.

Paying for professional expertise at the outset to get the contract document correct can save both sides on the cost of resolving disputes. Professionally drafted, plain English documents give a good starting point and reduce the risks for everyone.

### Complex Tax Based Investments

Clients with strong cashflow often ask about ways to minimise their tax bills. Tax-based investments are widely promoted. These ventures generate tax losses in the early years. The early tax losses are usually more than the amount you initially invest.

The IRD has warned investors to think through the potential risks and problems associated with these ventures. There is a strong focus inside the IRD on avoidance. Current discussions suggest that the tax deduction available to investors in these ventures may be limited to the dollars outlaid.



Examine the documentation closely if you are considering a tax minimisation opportunity. Seek advice and ask questions. As always, we are happy to comment and help before you commit your funds.

### Working in New Zealand?

New Zealand based businesses employing non-resident contractors are required to deduct 15% withholding tax from contract payments. A non-resident contractor means any "person" (including companies, local or public authority and incorporated bodies of persons) working in NZ

who is deemed a non-resident for taxation purposes.

From 1 April 2002, a law change removes the need for short term non-resident contractors to hold a certificate of exemption. If the non-resident contractor is from a country with whom NZ has a double tax agreement and works here for less than 62 days in any 12 month period, no non-resident withholding tax (NRWT) deductions are required.

### Trading Stock

At each year end you are reminded to value your trading stock. A new tax simplification measure will allow smaller taxpayers to use a simpler approach.

If, based on your reasonable estimate, your business has less than \$5,000 worth of trading stock at year end and you made taxable supplies for GST of less than \$1.3 million in an income year, you will not be required to value trading stock. In addition any change in value will not have to be accounted for as income.

### Interest Deductions for Companies

For businesses borrowing money, managing the interest payments is an important part of business life. In the past most interest costs were deductible, although sometimes complex structuring was necessary to ensure that company borrowing costs met the requirements for deductibility in the tax laws.

New legislation enacted last year will ensure that interest on borrowing by companies is deductible in most situations. For companies, the tax planning and structuring of interest and borrowings will be a thing of the past. Another welcome simplification change!

### Interest Rates

The ASB Bank Chief Economist offers the following comment on interest rates.

That interest rates will rise further this year is uncontroversial. How far

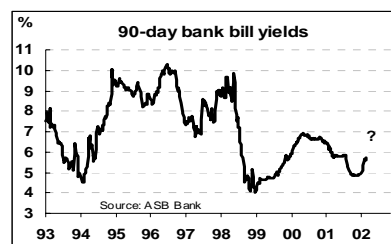
and for how long far are the key uncertainties.

The latter is probably the simpler issue. Rates are rising because monetary policy is being tightened, both here and abroad. For the most part, this tightening is the unwinding of the looser policy sought last year when low growth was a threat. Typically the tightening phase following a period of recession or slowdown lasts around 12-18 months. In other words, the rate rises come quickly. This suggests peak interest rates could be attained this year or, at least, by mid 2003.

Just what that peak will be is far more difficult to predict. If the 99/00 phase were repeated, the 90-day bank bill peak would be 7-8%. If more like 1994, then 9-10%. At this stage, the former appears more likely. For one, the target sought by the Reserve Bank of NZ these days is by no means as stringent as that applied in the early 90s. Then there are issues of expectations, competitiveness and adaptability.

For many, this logic is probably not new. At least, one would think so as the market is already pricing in significant interest rate hikes this year. Medium and long-term rates have already risen a long way.

From a risk management point of view, these higher medium-term rates are attractive. They are relatively high for investors and they offer rate security for borrowers in this time when short-term rates are rising. For the "punter", the trade-off is not as clear-cut. The best advice here would be to keep up to date with information and opinions, e.g. [www.asbbank.co.nz/reports](http://www.asbbank.co.nz/reports)



If you have any questions on newsletter items please contact us, we're only too happy to help.