

NEWSLETTER

November/December 2003

WHAT ARE YOU WORTH TO YOUR BUSINESS?

Shareholder-Employee Salaries & Excessive Remuneration

What are you worth? Each year companies calculate a profit position and decide to either allocate salaries to shareholder-employees or retain the profits as company income. When making the allocation decision it is important to consider both excessive remuneration and below market salaries. Both topics interest Inland Revenue.

Excessive remuneration occurs when a company pays more to a shareholder-employee than the Commissioner regards as reasonable for the work completed. The excess payment may be treated as a dividend. If this occurs, the company cannot obtain a deduction in its tax return as the payment is not salary, wages or management remuneration.

Certain payments are exempt from the excessive remuneration definition. These are payments where:

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- The recipient is an adult, employed largely full time in the business and participating in the administration or management of the company; and,
- The remuneration is not influenced by the recipient being a relative of a shareholder or director; and,
- The recipient is a New Zealand resident.

Payments that are likely to be caught by the excessive remuneration are those directed to a child relative or a spouse who does very little work for the business. The person may be engaged in full time study or employment elsewhere. If these payments are challenged, the onus rests with the company to establish a market rate for the work completed.

Under the current taxation regime, it is more likely that your business may be paying below market remuneration to cap shareholder-employee salaries under the \$60,000 threshold. Above that level the 39% marginal tax rate applies.

There are no tax rules that specifically attack below market salaries, however, the court commented on this issue last year. Tax Case V20 concerned an alleged tax avoidance arrangement. The judge considered that a below market salary which was part of a restructuring plan pointed to tax avoidance. This case is under appeal. The Inland Revenue would have difficulty invoking the tax avoidance provisions solely because a company pays a salary which is below market rates.

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DISPUTES RESOLUTION

The Government has released a Discussion Document which focuses on how disputes are processed by the IRD. The aims of the disputes process are:

- to make sure that your assessments for all tax types are as correct as practicable; and,
- to deal with disputes fairly, efficiently and quickly.

Clients who have experienced disputes will be aware that the current process is drawn out and frustrating. Many of the new proposals will simplify and streamline the system.

However one change is of concern. The proposal to limit to two years the time within which taxpayers can make a GST input tax adjustment. Practically, taxpayers may not realise they are entitled to a GST input claim until they are alerted to the entitlement by an accountant or solicitor or the disposal of the asset may trigger an enquiry as to whether a refund was ever sought.

We are concerned that the two year window may not provide enough time for taxpayers to exercise their rights. We will keep you advised of the final change when it comes through.

NON-RESIDENT CONTRACTORS

Businesses that use non-resident contractors to carry out work for them in New Zealand occasionally discover that they have unexpected obligations. For example, many local businesses buy machinery from overseas that requires installation and technical support. Any payments to non-residents involved in the back up work carried out here may be subject to withholding tax payable by the New Zealand business.

The non-resident contractor legislation in the Income Tax Act is designed to ensure that New Zealand captures some tax from

those non-residents who come and work here. The non-resident working here can be an individual, company, or other entity. The obligation to deduct non-resident contractor withholding tax (NRCWT) lies with the NZ business using the contract services. The current NRCWT rate is 15%.

The NRCWT legislation catches any contract service provided by a non-resident and carried out in New Zealand. The description of contract services is very wide and includes the granting, providing, or supplying of the use, or the right to use, in New Zealand the personal property or the services of another party.

There are some situations where businesses are not required to deduct NRCWT, these include:

- Contractors who work here for less than 62 days in any 12 month period. The 62 days is measured across all of the work completed for local businesses not just the work completed for your business; and,
- Contractors that hold a valid COE (Certificate of Exemption) from withholding tax.

On 1 December changes to the non-resident contractor rules come into effect. These changes include:

- An extension of the 62 day period to 92 days for contractors coming from countries with which we have a double tax agreement.
- An exemption from the requirement to deduct NRCWT for businesses paying less than \$15,000 of non-resident contractor payments in any 12 month period.

If your business uses non-resident contractors – either individuals or companies - and the payment to the contractors will exceed \$15,000 over a 12 month period – you must ensure that you ask sufficient questions at the outset to work out whether you should be deducting NRCWT. These questions should include:

- How many days have you worked in NZ over the past 12 months?
- Do you have a NZ IRD Number? If not it will be necessary to obtain one. Otherwise you must apply the IRD's non-declaration rate of 45%.
- Do you have a valid COE? If not, can you apply for one immediately so that there will be no requirement to deduct NRCWT?

Penalties apply to the NZ business if NRCWT is not deducted and returned correctly. If you are not sure whether NRCWT applies in your situation, please ask us for guidance.

DR CULLEN AND MOTIVATING DESIRABLE IMMIGRANTS

Recently Dr Cullen addressed the 2003 Tax Conference and suggested that New Zealand revisits the taxation of new residents. He is proposing a temporary exemption from tax for 7 years on overseas income for new immigrants, and New Zealanders returning after a 10+ year absence.

The tax holiday would apply to income earned offshore by people who come to work here. Income earned in New Zealand would still be taxed. The holiday will not apply to new immigrants or returning New Zealanders who are not in work.

Desirable immigrants with a strong skill base are in demand all over the world. The change is designed to make New Zealand a more attractive destination for these highly skilled overseas recruits. It should also act as a motivator and provide a tax saving opportunity for returning Kiwis who may be able to plan for investments to remain in a low tax jurisdiction for the proposed 7 year window.

ACC MOTOR VEHICLE LEVY CHANGES & EXCISE DUTY REFUNDS

The ACC Motor Vehicle Account provides personal injury cover to everyone injured in motor vehicle related road crashes on public roads. The cover is paid for from levies collected through an excise duty on petrol sales and as part of our motor vehicle licensing fee.

From 1 July 2003 the ACC levy rate increased. This is funded by an increase in the petrol excise duty from 2.3 cents to 5.08 cents per litre of petrol. Owners of non-petrol vehicles also face an increase, but not through their fuel costs, rather through a 19% increase in their licence fee.

Some motor vehicle users are entitled to a refund of the excise duty paid and the GST charged for fuel that's used. Refunds apply to fuel used:

- in an exempt vehicle
- in a road user charges licensed vehicle
- as fuel in a commercial vessel
- for commercial purposes other than as fuel in a motor vehicle, vessel or aircraft, e.g. to fuel factory machinery.

"Exempt vehicles" include farming vehicles, some mobile machinery and commercial vehicles that don't travel on the road. The refund available for fuel used in the above vehicles is approximately 20% of the fuel bill. For most businesses the refund will certainly be worth the paperwork!

Refunds are claimed on Form MR70 available from your nearest Land Transport Safety Authority (LTSA) office. Claims should be made within 3 months of the close of each quarter, i.e. by 31 December this year for the quarter ended 30 September 2003. The refund on late claims is reduced by 10%. More information can be found on www.ltsa.govt.nz

ELECTRONIC PAYMENTS TO THE IRD

Electronic banking is an efficient way to pay your tax to the IRD. Westpac, ANZ, Kiwibank or National Bank customers can pay using their bank's online 'tax payment' service. This service ensures sufficient payment reference details are included with your payment, as outlined below:

Payee name:

I	N	L	A	N	D		R	E	V	E	N	U	E
---	---	---	---	---	---	--	---	---	---	---	---	---	---

Bank Number:

0	3
---	---

Branch Number:

0	0	4	9
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Account Number:

0	0	0	1	1	0
---	---	---	---	---	---

Suffix:

2	7	
---	---	--

If there are three boxes for the Suffix, leave the last box blank.

Particulars:

0	1	2	3	4	5	6	7			
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(Taxpayer's IRD number)

Payee Code

0	0	0		T	A	X		G	S	T
---	---	---	--	---	---	---	--	---	---	---

Three zeros should be put in the first three boxes, a blank box left, and then TAX printed in the next three boxes. After the next blank box, print the tax type to which the payment should be credited, e.g. INC, PAYE, GST, RWT, etc. Provisional tax payments are credited to INC (Income Tax).

Reference

3	0	0	9	2	0	0	3			
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The reference is the period end to which the payment relates. It is not the date you make the payment. In the above example, the GST period ends on 30 September even though the payment and return are due on 31 October 2003. The date is printed as: 2 digit day, 2 digit month and 4 digit year. The correct period end date is printed on the form you complete and return to the IRD (e.g. Employer Monthly

Schedule, GST Return, FBT Return, etc).

Online Banking & Timing of Tax Payments

Payments must be made before the end of online banking "business" hours if they are to be received by the IRD on that day. Check with your bank if you are not sure of the online banking cut-off time for same day crediting.

GST AND SECONDHAND GOODS

Generally, taxpayers buying goods from a person who is not registered for GST can make a secondhand goods claim to get a GST refund. This general rule is subject to various limitations in the GST legislation. Some situations to look out for are outlined below.

Purchases from an Associated Person

No GST input may be claimed if you have bought goods from an associated person and that person did not pay GST when buying the goods. This will apply if the associated person bought the goods before 1 October 1986 or from an unregistered person.

For example: Tiny Tim is a shareholder in Tiny Tim's Trades Limited. Tiny Tim decides to sell his privately owned station wagon to the company for use in the business. Tiny Tim bought the car privately a few years back from a person who was not registered for GST.

Can Tiny Tim's Trades Limited obtain a GST refund? Answer: No. Because Tiny Tim did not pay any GST on the original purchase price.

Would the answer be different if Tiny Tim had bought the station wagon from a GST registered car dealer? Answer: Yes. Because Tiny Tim would have been charged GST on the original purchase. The GST claim would be the lower of 1/9th of the current value and the GST originally paid.

There is no logic in this answer. We are simply restating the GST rules. But, if you are contemplating transferring property from an associated person into a GST registered entity, please call us to check whether you will be entitled to a secondhand goods input claim.

Secondhand Goods claims by Taxpayers on the Invoice Basis

Generally taxpayers registered for GST on the invoice basis can claim a refund of GST if they have been invoiced for particular goods or services.

However, where the goods purchased are secondhand, the taxpayer seeking the GST input claim must have actually paid for the goods. Payment could be by way of cash, cheque, credit card, a deed of acknowledgement of debt or other means. For large transactions the Inland Revenue Department will often ask to sight the contract documents, invoice, and proof that payment has occurred.

Warning! If you are GST registered on the invoice basis and not sure whether you are entitled to an input claim, please check with us first. The penalties and interest cost for claiming earlier than permitted are substantial.

Claims for Supplies by GST Registered Vendors

Occasionally GST registered vendors do not supply the purchasers of goods with a tax invoice. When this happens, the buyer cannot obtain a GST refund. Taxpayers must hold a relevant tax invoice at the time of filing a GST return in order to make a valid GST input claim.

Before making a secondhand goods claim, you should ask the supplier for written confirmation that they are not registered for GST. If confirmation is not forthcoming, ask for a tax invoice. GST registered suppliers must provide a tax invoice on request.

CESSATION OF TAXABLE ACTIVITY FOR GST

Occasionally clients cease a taxable activity but continue to maintain their GST registration and file "Nil" GST returns. Inland Revenue must be notified when taxable activities cease. The legislation requires notification within 21 days of cessation. The notification is made in advance of deregistration.

Once your business sale is finalized you should complete a final GST return and fill out an IR315 Business Cessation form. The Inland Revenue will confirm the deregistration. If you receive any payment for GST supplies subsequent to deregistration or wish to make any adjustments, you can advise Inland Revenue in writing.

PAYING SCHOOL CHILDREN TO WORK IN YOUR BUSINESS

School children are liable to income tax in the same way as other taxpayers. However, school children whose total earnings from all employment does not exceed \$20 per week and/or \$1,040 per year are not required to provide their IRD number to their employer and it is not necessary to deduct PAYE. PAYE or withholding tax must be deducted if the school child is earning more than the thresholds above.

Where a school child does not provide an IRD number, and total earnings exceed the thresholds, you must deduct PAYE at the "Non Declaration" rate of 45c in the dollar.

If you pay your own children to work in your business or on your farm, the pay rate should reflect the effort put in and the market rate for similar casual or part-time work.

There is no threshold for university, polytechnic, and tertiary students. PAYE or withholding tax should be

deducted from their wages or contract payments. Tertiary students working part-time should be encouraged to apply for a special tax code certificate. Otherwise they will pay tax at the normal rates and have to lodge a tax return to get a refund. Applications for a special tax code are made on form IR23 BS.

FAMILY ASSISTANCE

The Inland Revenue is undertaking a new drive to make taxpayers aware of their family assistance entitlements. Family Assistance is designed to give financial help to working families with financially dependent children under the age of 18 who are living at home.

Family Assistance has four parts and depending on family circumstances taxpayers may be entitled to more than one type of help. The four parts are:

Parental Tax Credit: Payment for when a baby is born. Depending on a family's income, this could be as much as \$1,200.

Family Support: Ongoing financial support for working families.

Child Tax Credit: A payment of up to \$15 a week for each child 18 years or under who lives at home.

Family Tax Credit: For working families with one or more children to top up their income so that a family gets (the minimum wage) of at least \$286 a week (after tax).

If you would like us to review your Family Assistance entitlement, please call us. We can make a retrospective request if you were eligible for assistance in an earlier tax year and have not applied for your entitlement.

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