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REPORT - JUNE 2017

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The information contained in this report is not advice. We recommend that before readers decide to proceed with any of the matters raised below, that they contact their professional advisors.

WE HAVE MOVED

As reported in our last Report, we have now moved to 3 City Road. We have pretty much settled into our new premises bar some fit-out issues that needs to be resolved with the contractor and landlord.

Our office is situated on the left side of the ground floor of what is currently called the College of Law Building. With our rebranding, signage is currently being designed and we are hopeful that this will be in place by the end of the month.

To get to our free client carparks, the easiest route is to turn into City Road (behind the Langham Hotel) from Symonds Street and turn right into the very first driveway and then right again into the top level of the carpark. We have the first two carparks, undercover on the right, clearly marked. We look forward to welcoming you here.

FAMILY INCOMES PACKAGE

In the recent Budget, the Government delivered a Family Incomes Package that is likely to benefit 1.3 million families. '*The Family Incomes Package is carefully designed to assist low and middle income earners with young families and higher housing costs*' - Ministerial Statement.

Of particular interest to us were the changes to the income thresholds for which the existing tax rates applied to. One of the main reasons for the adjustment to the thresholds that have been in place since 2010, is to account for the increase in the average wage from $49,500 to $58,900. The average wage earner will now see an increase of $20.38 a week in their pay pack.

For a taxpayer earning $70,000 a year, they are now paying $14,020 tax but it will decrease to $12,960 from 1 April 2018.

CURRENT INCOME	TAX RATE	NEW THRESHOLDS 1/4/18
$0 - $14,000	10.50%	$0 - $22,000
$14,001 - $48,000	17.50%	$22,001 - $52,000
$48,001 - $70,000	30%	$52,001 - $70,000
Over $70,000	33%	Over $70,000

PROVISIONAL TAX IMPROVEMENTS

New legislation enacted in February substantially simplifies obligations under the provisional tax regime.

Most taxpayers pay their provisional tax at three times through the course of their financial year, being the 5th, 9th and 13th months after their balance date. For most taxpayers with standard March balance dates, this falls in August, January and May. The 'standard uplift' method determines a person's liability based on a prior year's tax payable (105% for last year, or 110% for previous). The problem is that if a person's final liability is more than the estimate, Inland Revenue will charge use-of-money interest (UOMI) on the difference (currently 8.27%).

This is a source of frustration as taxpayers are either rewarded for having a great year by being charged interest by IRD, or they have to scrutinise their own tax position as they trade through the year and make increased payments to IRD when they could be focusing on their business.

In a positive change, the UOMI rules are being amended from the 2017/2018 income year. UOMI will no longer be charged from the first two provisional tax dates on the difference between a person's 'standard uplift' liability and their actual liability based on their completed tax return.

In order to defer the start of the interest charge the taxpayer must meet the minimum payment obligations under the standard uplift method on the first two instalment dates. Where the taxpayer does not make the required payments, UOMI will apply on the first two instalment dates based on the lower of the difference between: the amount due under standard uplift and the actual payment; or one-third of the residual income tax liability for the year and the actual payment.

To be eligible for the concession, companies within a group will all be required to use either the standard uplift or GST ratio method for calculating provisional tax. This rule is designed to prevent related entities gaming the differences between the standard uplift and estimation methods to reduce exposure to UOMI.

In a similarly positive change, the existing concession, which defers UOMI for individuals with a tax liability of less than $50,000 to their terminal tax date (typically the following 7 February or 7 April), is being increased and widened. From the 2017/2018 income year, the concession is being increased to $60,000 and extended to all types of taxpayers, such as companies.

As with the first change above, there are requirements that need to be met in order for the concession to apply, such as meeting obligations under the standard uplift method. IRD expects that the change to the safe harbour threshold will eliminate UOMI charges for approximately 67,000 taxpayers, at least 63,000 of these being non-individuals who did not previously qualify for the concession.

Finally, the late penalty regime is also changing. Currently, a 1% late payment penalty is charged the day after tax is due, a further 4% penalty is charged at the end of the first week (a total of 5.04%) and a 1% incremental late payment penalty is charged each month thereafter. For most taxpayers the incremental 1% monthly penalty will no longer be charged on GST periods starting from 1 April 2017 or income tax and working for families debts relating to the 2017/2018 or later years. However, whilst this incremental late payment penalty won't be charged, UOMI still applies.

TAXATION OF INSURANCE RECEIPTS

New Zealand has taken a battering in recent years from major disasters including earthquakes, fires, cyclones and floods. These have caused business disruptions, devastated lands, and damaged our capital's infrastructure and homes. Where insurance is received, a question often asked is how these receipts should be treated for tax purposes.

Whether insurance proceeds are taxable will depend on what the proceeds are received for. If proceeds are for items of a revenue nature, such as loss of profits, rents, or reimbursement of business expenses, the proceeds will generally be taxable. Receipts for income protection will also be taxable because they are typically based on loss of earnings and especially if you have been claiming a tax deduction for the premiums. Insurance proceeds for capital items such as residential properties and loss of land, will generally not be taxable, unless you are in the business of dealing in property.

Depreciable assets - compensation received for depreciable assets is treated as though the asset has been sold to the insurance company for the amount of the compensation received. If the compensation is less than the asset's tax book value (TBV), a loss on disposal can be claimed (for assets other than a building). However, where it is more, tax will need to be paid on any gain made above TBV (i.e. depreciation recovery income is recognised). Any gain above the asset's original cost is a tax free capital gain.

The Canterbury Earthquake - specific provisions were enacted for buildings that were damaged in the Canterbury earthquake. As a starting point, proceeds will always be taxable to the extent of the cost of repairs. This results in a net nil position for income tax purposes. Where proceeds exceed the cost of repairs ("the excess"), the tax treatment will depend on whether the property is deemed "repairable" or "irreparably damaged".

For "repairable" property, the excess is deducted from the property's TBV. If the adjusted TBV is reduced below zero, the negative TBV would ordinarily be taxable depreciable recovery income. This is however, limited to the lesser of the negative

TBV and the actual depreciation claimed to date and is taxable in the income year in which the proceeds are applied to reduce the TBV. Any remaining amount will be treated as a capital gain. Conversely, if the excess does not cause the adjusted TBV to become negative, the depreciation recovery income will be deferred until the property is later sold.

A property will be "irreparably damaged" if it has been rendered useless for deriving income and is demolished or abandoned for later demolition. This should be agreed with the insurer and documented in the settlement agreement. The property is treated as sold for the amount of the insurance proceeds, and reacquired for nil consideration. Any depreciation recovery income can be deferred and offset against a replacement asset that is purchased by the 2018/2019 income tax year. The remainder will be a capital gain. The proceeds of a future sale will be all capital gain, assuming no other taxing provision applies as the property's tax base is nil for depreciation purposes.

BEWARE OF PAYING EXCESSIVE SALARIES

It is very common for family owned companies to employ members of the family in the business on a permanent or casual basis. There is no problem with this per se, however income tax rules seek to prevent 'excessive salaries' being paid to family members.

Inland Revenue has recently been focusing on this issue and has been scrutinising the type of work completed, the amount paid, the way in which it was calculated, and what a third party might be paid for the same work.

There is no precise measurement as to what constitutes 'excessive', as each case is different. What is most important is that business owners determine the value of a relative's remuneration based on the service provided to the business. The relative should be paid the same amount as an unrelated employee performing similar duties.

IR has the ability to intervene and reallocate remuneration, income or losses if it considers the amount is not reflective of the value contributed. If an amount is deemed to be excessive, the excess may be re-characterised as a dividend and therefore non-deductible to the payer. Where salaries to family members are paid it is important to ensure the employment and the amount paid is calculated and documented on an arms-length basis.

OPPORTUNITIES FOR INNOVATION

Businesses that heavily invest in R&D commonly experience cash flow problems. This is because it can take years of sustained R&D before they come up with a marketable product or service that derives a profit. To help overcome this problem and encourage innovation in NZ, the government offers a few support mechanisms.

The R&D loss tax credit regime is one such mechanism, introduced in 2016 as part of the government's Business Growth Agenda. Before the regime was introduced, R&D intensive companies that made a tax loss could only carry the loss forward to future income years to offset against future years' income. Under the new regime, tax losses arising from eligible R&D expenditure can be refunded in cash to the company each year. There are eligibility criteria that must be satisfied, for example at least 20% of the entity's wage bill needs to relate to R&D functions. The regime provides R&D intensive companies with much needed cash during the initial investment stage of projects. The regime has been in place for over a year now, with a number of companies receiving significant cash refunds from Inland Revenue as a direct consequence of their R&D spend.

In addition to this, the Ministry of Business, Innovation and Employment is responsible for encouraging innovation in New Zealand businesses and has a number of grants and funds available.

The Endeavour fund invests in research aimed towards sustainability and integrity of the environment, transforming New Zealand's economic performance, and strengthening society. Funding is available across a variety of areas, with up to $1 million per applicant available.

For businesses undertaking research in conjunction with other overseas parties, the Catalyst fund (previously known as the International Relationships Fund) is available to support activities that are aimed towards creating multilateral partnerships between New Zealand and other countries, to improve the quality of New Zealand's science and innovation.

The Government agency, Callaghan Innovation, also offers a range of R&D grants aimed at hi-tech businesses. For example 'Getting Started Grants' are aimed at New Zealand businesses who are in the early stages of, or new to R&D, and 'Project Grants' are available for businesses who need support in developing specific R&D projects.

IRD AUDIT INSURANCE

If you haven't yet taken up cover, an abated invoice for the period up to February 2018 has been sent to you. In view of the IRD's increased activity in this area, we recommend that you take up the cover. Note that the cover kicks in only after payment is made . If notification of an audit is received before payment is made, you will not be covered. If you will not take it up, please sign the decline option and return to us so we do not continually send out reminders.