

TaxTeamTalk

Tertiary Budget edition May 2011



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Budget 2011

Last week, the Finance Minister delivered a 2011 Budget with very few tax changes but a significant focus on funding matters.

For the tertiary sector, the Budget did announce funding for specific projects; however, we do not expect any specific tax implications to arise from these.

The principal Budget changes relate to the Working for Families, KiwiSaver, and student loan schemes. This newsletter focuses on important Budget initiatives that are relevant to the tertiary sector. We also outline recent tax developments of which you should be aware.



Student loan changes



The Budget confirmed announcements by the Minister of Tertiary Education regarding changes to the student loan scheme.

Aside from tax compliance ramifications, the changes may well have an impact on revenue for tertiary education providers. The principal changes are that:

- Students with overdue payments of \$500 or more and who are in default for more than one year will have their eligibility for further loans restricted;
- Students aged 55 and over will be eligible for loans for tuition fees only; and
- The entitlement for part-time students to borrow for course-related costs will be removed.

We expect these changes to make tertiary education less attainable for some students, thereby reducing the demand for tertiary services.

Enrolments are most likely to dwindle in courses popular with part-time and mature students, given the reduction of assistance to those groups.

KiwiSaver

In an attempt to shift the fiscal cost of KiwiSaver away from public funding and towards private savings, the Budget introduced a number of changes to KiwiSaver.

The key changes

- **Member tax credits** (“MTCs”) will be halved from the current maximum of \$1,042 to \$521 a year. This will effectively apply from 1 July 2011, and will be reflected in payments to KiwiSaver accounts in the second half of 2012.
- **Employer Superannuation Contribution Tax** (“ESCT”):
 - From 1 April 2012, the ESCT exemption that applied to employer contributions to KiwiSaver and other complying superannuation funds will be removed.
 - From 1 April 2012, the current default ESCT rate of 33% will be removed, which means that you will have to calculate and pay ESCT to the IRD at the employee’s marginal tax rate.
- From 1 April 2013, the minimum **employee contribution rate** will increase from 2% to 3%.
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What the changes mean to you

Contributions holidays

As a result of these announcements, you may receive requests from employees wishing to take a contributions holiday from KiwiSaver. When processing such requests it is important to note that:

- Contributions holidays can only be taken by employees who have been in KiwiSaver for one year or more; and
- You must continue accounting for both employer and employee contributions until you receive a letter from the IRD approving the employee’s contributions holiday.

Calculation and payment of ESCT

As the default ESCT rate of 33% will be removed from 1 April 2012, all employer contributions will be subject to ESCT calculated at the employee’s marginal tax rate.

Given the specific ESCT exemption that has historically applied to KiwiSaver, you should not have previously paid ESCT on KiwiSaver contributions up to 2%. With the ESCT exemption removed, *all* employer contributions will be subject to ESCT. You will need to check that your payroll systems can perform these calculations correctly.

Employment contracts

Depending on how an employment contract has been drafted, the employee may end up bearing the costs of these KiwiSaver changes.

If employment contracts are drafted on a ‘total remuneration’ basis, the employer KiwiSaver contributions may be deducted from the employee’s gross salary. In these cases, increases in

employer KiwiSaver contributions impose no additional cost on employers, since the costs of KiwiSaver are typically passed on to the employee by way of salary sacrifice.

However, for employment contracts drafted on a ‘base salary plus other benefits’ basis, the employer incurs the employer KiwiSaver contributions in addition to the base salary, meaning that the employer KiwiSaver contribution is an actual cost to employers.

As such, employers should review all existing employment contracts to evaluate the impact of these upcoming changes, and also review templates to ensure that the costs of KiwiSaver are managed appropriately for future employees.



Tax compliance audits

The Minister of Revenue announced that, for the first nine months of the 2010/2011 financial year, every dollar that the IRD invested in tax compliance recovered **six** dollars of tax.

This success justifies the IRD’s approach to ensuring that organisations are “getting it right at source”, as outlined in its Tax Compliance Focus Report for the 2010/11 financial year.

Although Budget 2011 provided no *extra* funding for the IRD, extra funding of \$120 million was announced last year specifically for the IRD to bolster its tax compliance audits over a four-year period.

We have seen a significant increase in IRD audit activity in the public sector over the last two years—the greatest impact on organisations being the time-cost associated with the audit.

GST input tax entitlement

From 1 April 2011, the entitlement to a deduction for GST input tax will be based on a fair and reasonable estimate of the intended use of the good or service.

The new rules only apply to organisations where the total value of exempt supplies exceeds:

- \$90,000; or
- 5% of total consideration received for all taxable and exempt supplies.

Those organisations must now specifically evaluate each good or service acquired, to determine the extent to which it is used to make taxable supplies.

If you only acquire goods and services for 100% taxable or 100% exempt use, the applicable GST treatment will not change. However, for goods and services acquired for a "mixed use", you will now be required to:

- Claim GST input tax on acquisition only to the extent to which the goods or services are used for making taxable supplies;
- Monitor the usage of the good or service, and make GST adjustments for any "significant variance" in use;
- Consider whether a further GST input tax adjustment is available upon disposal of goods; and
- Apply special rules to determine GST input tax entitlements/adjustments if the good acquired is land.

Accommodation

The GST treatment of the supply of accommodation has changed.

The changes involve:

- Narrowing the definition of "dwelling", the rental of which is exempt from GST; and
- Broadening the definition of commercial dwelling, which is subject to GST.

Specifically, the definition of "dwelling" has been amended to mean a place that a person occupies as their "principal place of residence" where they have "quiet enjoyment". Both are new terms introduced to the GST Act.

As a result, some forms of accommodation may now be subject to GST that previously were not, or vice versa, and your existing GST treatment may need to change in line with the amended definitions.

This area is particularly important for suppliers of student accommodation. The GST treatment in light of these new changes is unclear, and we are currently working with the IRD to gain some certainty on how the new rules will apply. Clarity in this area is also vital because the *proportion* of taxable to exempt supplies affects the GST input tax entitlement.

For guidance on the potential impact of these new rules, contact your TaxTeam advisor.

Land transactions

The new rules have *significantly* changed how GST is accounted for on land transactions.

From 1 April 2011, the supply of land, or a supply that involves land, to another GST-registered person for taxable purposes *must be zero-rated* (i.e. charged with GST at 0%). To zero-rate a supply involving land, you will need to hold a written statement from the purchaser stating that they:

- Are GST-registered;
- Intend to use the land to make taxable supplies; and
- Do not intend to use the land as a principal place of residence for themselves or an associated person.

You must also be prepared to provide such statements when purchasing land, and understand the consequences of such statements. The rules also shift the risk of applying the wrong GST treatment from the supplier to the purchaser. That is, your organisation would be liable for any tax shortfall if you were to make a false or incorrect statement on a land purchase.

A new definition of "land" has also been introduced. For the purposes of the zero-rating rules and the new apportionment rules, land is defined broadly, and includes an interest, or a right to an interest, in land.

For zero-rated land with a mixed use (e.g. purchased for a taxable activity but temporarily let out for exempt accommodation), you must apply the new GST apportionment rules and make a GST output tax adjustment to the extent of the exempt use.



Honoraria

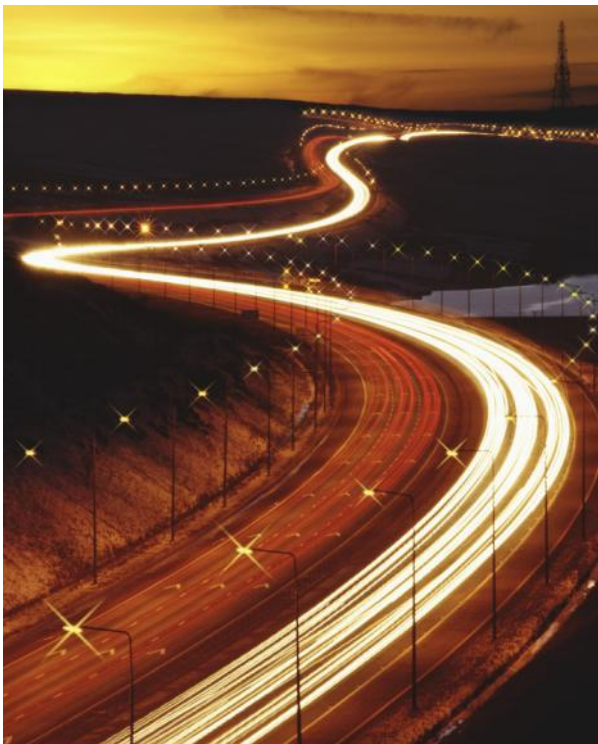
For a long time, there has been ambiguity around the tax treatment of payments made to Committee/Council members for their services, as well as for reimbursement and allowance payments.

New legislation has removed this ambiguity, providing that payments for *work or services* performed in a Committee/Council member's elected role are subject to withholding tax. Previously, these were treated as honoraria, but a specific new payment category has been introduced.

A key difference in the definition is that expense reimbursements or allowance payments to Committee/Council members are *not* payment for work or services, so are *not* subject to withholding tax. The Committee/Council member will be responsible for determining the tax treatment in their own tax return.

Now is a good time to review all payments to Committee/Council members.

Mileage reimbursements



The IRD has increased the approved mileage rate that may be used to reimburse employees tax-free for private use of their vehicles, from 70 cents to **74 cents** per kilometre ("IRD rate"). This amendment is effective from 27 April 2011.

The IRD rate is intended to reflect a reasonable estimate of the costs involved in vehicle-use, and is based on surveying the running costs of both petrol and diesel vehicles across a range of engine sizes, over 14,000 kilometres of travel a year. These running costs do not focus solely on the cost of petrol/diesel, but include all costs relating to vehicle ownership, such as insurance, maintenance, etc.

An increase in the mileage rate may result in increased costs to the organisation, so this should be closely considered before implementing a change. Importantly, if your employment agreements refer to the approved IRD rate, your systems will need to change to reflect the increase.

You are *not required* to use the IRD rate—you can use any method that provides a reasonable estimate of the likely costs. Any such reimbursement calculated in this way can be paid tax-free. Other approved methods include the AA's published mileage rates.

Before reimbursing mileage for elected appointed officials at the new IRD rate, you may need to consider guidance from the Remuneration Authority or other regulatory body.

Canterbury Earthquake Relief payments

The Taxation (*Canterbury Earthquake Measures*) Bill was recently passed by Parliament.

The Bill provides that up to \$3,200-worth of cash and other benefits given to an employee within eight weeks of either earthquake can be provided as exempt income (i.e. not subject to PAYE). One of the conditions is that cash payments must not replace ordinary income of the employee. Non-cash benefits provided during the same period can be excluded from FBT (up to the \$3,200 per-employee threshold for total benefits).

If you have previously accounted for tax on such benefits, you may be entitled to a refund from the IRD.