

TaxTeamTalk

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In this issue...

Introduction

Apportionment rules and the ticking time-bomb?

Other recent issues

Top tips for an IRD audit

New GST rule—progress!

Software development

What's a home worth?

A hidden tax?

Into the cloud(s)

TaxTeam lead staff

Introduction

Welcome to another TaxTeam newsletter. With the election on the horizon, and the main parties' disparate approaches to many policy matters, this will be an interesting month!

Apportionment rules and the ticking time-bomb?

The GST apportionment rules still hang like a dark cloud over mixed-use assets acquired by local authorities on or after 1 April 2011. These are assets used for both taxable and exempt supplies (e.g. a computer system used for general council business *and* social housing).

Although unlikely to cause more trepidation than the last 10 minutes of the Rugby World Cup final, the "first adjustment period" for most local authorities in relation to such assets will end on 30 June 2012. In preparation for this, local authorities need to:

- Have a methodology in place for determining the percentage use of the assets in making taxable supplies;
- Perform an interim calculation to confirm that the methodology being used to determine that percentage is sound, to minimise the significant work required at the end of June (when, typically, annual reporting priorities create additional time pressures);
- Make at least one adjustment for assets sold before year-end; and
- In the context of land, with any calculation to be made for an adjustment period, consider whether the land is used "concurrently" for both taxable and exempt supplies. The technical meaning of this concept is still not necessarily clear!



TaxTeam recently assisted SOLGM in submitting to the IRD that local authorities be given the option to apply a specialised set of GST apportionment rules to mixed-use acquisitions. Despite this, local authorities will need to ensure that, at a minimum, they have an action plan for this.

Other recent issues

In the last quarter, TaxTeam has also undertaken a variety of interesting assignments, which included the following matters.

Making further submissions on behalf of our clients, including to the Ministers of Revenue and Energy on the appropriate GST treatment of contributions towards insulation and clean, efficient heating.

Providing tax advice to various local authorities, including:

- Identifying a significant GST refund relating to endowment land that had been sold over the last 20 years;

- Assisting with moving a resource and building consent application process to an online platform; and
- Advising on the tax status of a regional promotional body, in order to remove it from the income tax net.

Preparing binding rulings, including to maintain interest-deductibility on a loan obtained by a local authority.

If you any questions on any of these matters, please contact us.

Top tips for an IRD audit

As Sun Tzu said, “Every battle is won or lost before it is ever fought”. This also applies to IRD investigations.

Given the significant number of IRD investigations arising within the local authority, health and Central Government sectors, we thought it useful to set out our Top 10 Tips for winning the battle!

1. **Know your exposure.** Is the real cost to your organisation tax dollars, time, or political/public perception?
2. **Know your strengths.** Most public sector organisations are overly conservative, and probably overpay tax. Make sure you identify these overpayments.
3. **Demonstrate your strengths.** If the real cost of an investigation is business interference, spend some time educating the IRD about your business and its processes. It will be worth the investment.
4. **Know your enemy.** The IRD usually has a number of key goals in mind for an audit. Assess what these are, and help the IRD achieve its aims quickly.
5. **Use your allies.** Many organisations prefer to use external advisors to manage the audit process. This often brings rewards in the long run.
6. **Keep lines of communication open.** It is imperative that key stakeholders are aware that IRD audits are often routine. Management needs to maintain a ‘no surprises’ approach and ensure that stakeholders stay informed.
7. **Plan the battle and keep to it.** Set key deadlines. Regular (i.e. daily) feedback from the IRD is vital to keeping the audit plan on track.
8. **Support your forces.** It is important that staff are aware of the IRD’s powers, do not feel isolated or exposed, and do not breach rules around privacy, etc. Technical staff support is essential.
9. **Remember, it’s a battle and the war is never over!** View the outcomes positively and use an IRD investigation as an opportunity to agree ongoing tax compliance matters.
10. **Control your forces.** Good tax policy and procedure documentation will provide clear guidance to staff before an IRD investigation begins. The battle can be won before it is started.



New GST rule—progress!

In our August 2011 edition, we discussed a new GST rule that, among other things, may prevent you claiming GST on goods or services that you contract and pay for, then direct to be provided to another person.

The example we gave was where an organisation purchases flowers from a supplier to be sent to an employee, but this applies equally to, say, a payment to a refuse collection company that provides services to the public. This rule is known as the “nominee rule”.

As a result of the concerns that we raised with the IRD about the nominee rule, remedial legislation has been introduced in the latest tax Bill, which, if enacted in its current format, should mean that the GST is once again claimable on such goods and services.

Given that the Bill is unlikely to become law until sometime in 2012, concerns remain around exposure to penalties; i.e. what approach should one take now in terms of claiming GST before the proposed change is enacted?

Following discussion with the IRD, we have received written confirmation that the IRD will not start any audits specifically to consider issues related to the application of this rule.

However, the IRD also stated that:

“...if during the course of other audit activities, or as a result of a request initiated by a taxpayer, it becomes necessary for the Commissioner to alter an existing tax assessment, and as a result an incorrect (under current law) tax position taken in respect of section 60B(5) comes to the Commissioner’s attention, the law as it currently stands will be applied.”

This means that, if the IRD is auditing matters not specifically pertaining to the nominee rule, there will be scope for the IRD to:

- Review transactions subject to the nominee rule; and
- Impose penalties if the nominee rule has not been applied correctly – i.e. as the nominee rule currently reads.

If you have concerns about any such transactions, please contact us.

Software development

A recent tax Bill proposes to allow an income tax deduction for expenditure incurred on software development where the software development project was unsuccessful.

Not all expenditure incurred on an unsuccessful software development project will be tax-deductible. To qualify:

- The expenditure must be incurred with the main intention that it be used for business purposes;

- Development of the software must be abandoned before the software is fit to be used in the person's business;
- The person must have been entitled to a deduction for an amount of depreciation loss for the software if the software had been able to be used in the person's business; and
- No other deduction for the expenditure must be available under the Income Tax Act 2007 or any other Act.

The deduction, if available, is allocated to the income year in which the development project is abandoned. Once this provision is enacted, a deduction may be taken as early as the 2008/2009 income year (i.e. it is retrospective).

Given the potential for local authorities and, more specifically, certain CCOs to claim a retrospective deduction, we will be monitoring the Bill's progress.



What's a home worth?

The provision of accommodation to employees at low or nil cost is a benefit that is (peculiarly) taxed under the PAYE rules instead of the FBT rules. But how do you calculate the taxable value of that accommodation?

Let's take the example where the needs of the employee's job involve them living in employer-provided accommodation, such as park rangers or staff living in depots. Should the taxable amount be based on market value of rent at that location? Should that amount change depending on whether the employee is living in the house alone or with his family?

The IRD is currently considering a number of issues around the valuation of accommodation benefits. We will be submitting that discount factors should be applied for certain accommodation provided by an employer.

If you would like a copy of the submission, please contact us.

A hidden tax?

The 2011 Budget altered the treatment of Employer Superannuation Contribution Tax ("ESCT").

ESCT has been around for a number of years, but it is a tax that has been easy to avoid legally and, for those who did pay it, easy to calculate. That is all set to change. From 1 April 2012, the following changes to the ESCT rules will apply:

- The 2% exemption that currently applies to employer contributions to KiwiSaver and other complying superannuation funds will be removed. This means **all** employer contributions will be subject to ESCT.
- The current default ESCT rate of 33% will be removed, which means that ESCT will need to be calculated at each employee's marginal tax rate.

Given that the changes will be effective early next year, you may wish to consider the following:

- Have you determined whether the change will mean that contributions to your employees' superannuation funds will decrease? Or will you meet the increased cost as the employer?
- Have you told employees about the change?
- Do you need to adjust any policy documentation in line with this change?
- Will your payroll system need to be updated to ensure that the new calculations can be performed correctly?
- Have you planned for a review of your systems?

Employers should review all existing contracts to evaluate the impact of these upcoming changes, and amend their payroll systems accordingly.

Into the cloud(s)

All New Zealand businesses are required to physically store their business records in New Zealand, unless the IRD has specifically agreed otherwise.

Many businesses, however, have set up their IT infrastructures using cloud computing; an internet-based computing service that provides users with access to servers, software, applications, storage and networking, or any other aspects of computing over the internet.

Given that many of these servers are not physically located in New Zealand, a number of businesses are *inadvertently* operating outside of tax law.

A recent Bill proposes to simplify the process by allowing data storage companies to apply for IRD approval on their clients' behalf. This aims to remove barriers that may discourage taxpayers from using electronic filing systems such as cloud computing.

Have your IT people considered this?

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Vivienne Denby
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And introducing...



Tony Fuller
Senior Manager

Tony has recently joined us from PwC Auckland, where he held the role of Tax Director. He has been a tax professional for 17 years, including a 15-month stint in Melbourne in 1999/2000 to coincide with Australia's introduction of GST.

Tony's specialist industries have included forestry, construction and technology.