

NEWSLETTER

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Technology and R&M

The condition of New Zealand’s housing stock was hotly debated during the lead up to the election. Houses that were acceptable in the 1970’s are now considered outdated and low quality for 21st century living. With the introduction of a new Government we are waiting to see what changes will be implemented for landlords, for example, will a housing Warrant of Fitness be introduced?



Landlords may need to incur significant improvement costs to bring properties up to the required standard, so the inevitable question will arise - are the costs tax deductible, or capital in nature. Because buildings are not depreciable, if expenses are considered to be capital, no tax deduction will be available at all.

The process of determining whether expenditure comprises tax deductible repairs and maintenance work (R&M) has been established by the Courts, but it is inherently a judgement call and is open to interpretation. As a result, it is a common area of review by Inland Revenue during the investigation process.

Generally, where new building materials are used extensively, and perform different functions, then this may be considered a change in the character of the asset and therefore more likely to be capital in nature. However, one accepted means of treating expenditure as deductible R&M is on the basis of technological improvement. The rationale is based on the Privy Council decision in *Auckland Gas Co. Limited v CIR* in which Lord Nichols stated:

It often happens that, with improvements in technology, a replacement part is better than the original and will last longer or function better. That does not, of itself, change the character of the larger

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object or, hence, the appropriate description of the work.

Some objects do not lend themselves so readily to this exercise in characterisation...A house is a simple example of this. Demolition and rebuilding of a dangerous flank wall of a house would normally be regarded as repairing the house. The answer might not be so obvious if an entire derelict wing of a large house were demolished and rebuilt, especially if the new construction were substantially different from the original. Questions of degree may arise in such cases.

Inland Revenue's Interpretation Statement on R&M issued in 2012 briefly commented on the issue. Inland Revenue referred to the Auckland Gas example. In that case, a significant portion of the asset, being the gas network, was replaced with new pipes that performed differently. It was considered that the character of the gas distribution system had changed, hence the conclusion by the courts that the expenditure was capital in nature.

Let's take another common example. A landlord may choose to replace all of the windows of a rental property with double glazing. Double glazed

windows can make a substantial improvement to a home's heat retention, as it is often the windows and frames that are most susceptible to heat loss. However, there is a strong argument for concluding that the character of the house is unchanged. It is visually unchanged and the windows perform the same function. While not explicitly dictated as the only choice of window, they can be considered the new technical 'standard'.

In principle, the cost of making this type of improvement should be tax deductible. The tax benefit promotes the creation of healthier, greener homes. However, if in this example the landlord had chosen to replace the windows with a better product to improve the character of the house, then arguably a capital improvement has been made. Single glazed windows are available and common sense suggests the landlord would not have paid for the improvement if no advantage was gained.

Instead of replacing all of the windows, replacing the odd broken window from a stray cricket ball might help the landlord dodge Inland Revenue's capital improvement firing line.

Accommodation allowances

In today's fast changing commercial environment, it is common for employers to provide board or accommodation to employees, and move staff to new locations based on the needs of the business. This can occur when permanently moving an employee to a new location, or when temporarily seconding an employee to a different location.



also be paid tax free, such as moving and transportation costs. Refer to Inland Revenue's determination 09/04 for a complete list.

The value of board or accommodation provided to an employee generally comprises income of the employee and is subject to PAYE. However, in relocation scenarios, given the business drivers in these situations it is sometimes possible for accommodation to be provided tax free. The rules are prescriptive, so it is a case of working through them to confirm how they apply.

In the case of a permanent relocation, payments for accommodation may be treated as non-taxable to the employee for up to three months from arrival at the new location, providing they have moved to:

- take up employment with a new employer, or
- take up new duties at a new location with the existing employer, or
- continue in their current position, but at a new location.

If an accommodation allowance continues after this three month period, the payments will become taxable to the employee. Various other costs can

In the context of a temporary change in workplace, such as a secondment, the length of the secondment and its purpose will determine to what extent accommodation will be tax free. If the business intends the temporary relocation to last for a period up to 2 years, then the accommodation for the whole duration of the secondment can be treated as non-taxable. This tax free period can be extended to 3 years if the employee is working on a project to build, restore or demolish a capital asset. If it becomes evident that the employee will need to be seconded for more than 2 or 3 years, respectively, the accommodation will be taxable from the date expectations change.

Real life scenarios can of course be complicated and the rules themselves are complex as they attempt to accommodate (no pun intended) those situations. For example, the rules cater for employees with multiple workplaces, new employees who are placed on immediate secondment and extended periods due to exceptional circumstances, such as natural disasters.

For businesses encountering this scenario, the first priority is to ensure there is a system in place to

capture and record the provision of accommodation to employees. It is then a matter of confirming what the correct tax treatment is. There is no distinction between whether the employer pays an accommodation allowance or provides

accommodation directly. The rules can be complex depending on the situation, but tax is a business expense (and risk) like any other and should be managed accordingly.

Team development

Business owners and managers are often focused on a company's financial performance, return on investment and other monetary indicators of business success. Intangible investment in human capital can commonly be overlooked as it can be difficult to measure improvements, or any direct increase in outputs. However, employee effectiveness is critical to the performance of all business processes.



There are numerous approaches that can be used to increase the effectiveness of employees, of these the athlete-centred and employee-centred approaches are summarised below.

Using the sports field as an example, an athlete-centred approach has been proven to develop exceptional gamesmanship and understanding. Although you might not view your colleagues as a sports team, significant improvements can be made by investing time in staff development. Managers have a great opportunity to lead from the front and pave the way for a more effective organisation by creating a learning, rather than telling, work environment. To achieve this, managers need to view themselves more as teachers than autocrats. This allows employees the freedom to make errors and gives managers points to correct and teach from, developing a greater understanding of the problems at hand.

Graham Henry has an active focus on empowering the rugby players he coaches, giving them more responsibility, rather than using a dictatorial decision

making style. An important aspect of this is having a senior leadership team available to help set the tone of the group for situations both on and off the field. By allowing the senior leadership team control of almost all aspects of the team, the athletes have greater buy in and acceptance of team decisions.

Business owners could take a similar approach and create high performing teams to adopt an athlete-centred approach in business decision making processes.

The employee-centred approach relies on managers to empower their staff to take responsibility for their own work outputs, and make their own decisions.

A nurturing environment must be created for this 'employee-centred' approach to be successful. A 'teach, don't tell' coaching style is a core principle. Managers who avoid telling employees what to do, and instead test their understanding of topics through the use of leading questions, enable employees to develop their decision making ability and technical skills and still think through the problem themselves. The managers still 'teach' the employee in areas where there is a lack of knowledge, but the questioning style helps the employees broaden their knowledge and retain responsibility for their outputs.

Good managers will move between this 'teach don't tell' style of coaching, to a more prescriptive style as required by the situation.

Voluntary disclosures

Traddies have been under the watchful eye of Inland Revenue (IRD) for the last few years since being identified as a cash-dominated industry in 2012. A media campaign has recently been launched to warn tradespeople that doing 'cash jobs' may comprise tax evasion, and that every cash job leaves a trail (or lack of a trail) that can be tracked by IRD.

Tradespeople risk substantial financial consequences if they are caught understating taxable income in their tax



returns. Fines, penalties, use of money interest, and potential prosecution are all within the IRD's power.

This begs the question, if a business identifies an error and the correct amount of tax has not been paid, what should be done? Contrary to some views, it does not comprise a windfall gain. If a business has underpaid its tax by more than \$1,000 it must be disclosed to IRD. No business owner will take joy in having to pro-actively contact IRD, so here are a few points to

keep in mind which will help smooth the process. The best way to proceed is by making a written voluntary disclosure. With any re-assessment to increase a person's tax liability, IRD will consider whether shortfall penalties should be charged. If charged, the amount is based on a percentage of the tax shortfall and the percentage varies depending on the nature of the error and the taxpayer's culpability. The taxpayer should therefore use their written disclosure to clearly set out what the error is, how it arose and what actions have been taken to ensure it will not happen again. The disclosure provides an opportunity to explain the facts in the most favourable way possible. It reassures IRD of the taxpayers willingness to comply with the tax rules and demonstrates that the matter is being taken seriously.

The disclosure should also set out how the relevant tax return should be amended, with reference to the actual box numbers in the tax return. Broad statements regarding how the mistake should be fixed run the risk of IRD amending the return incorrectly, which will only give rise to more contact

with IRD – the taxpayer should make it extremely easy for the person processing the change to get it right.

In most cases, if a voluntary disclosure is made no shortfall penalty should be charged.

In a small number of cases, the IRD may receive the disclosure and commence an investigation. IRD could potentially take the view that if one error was made, something else might be wrong. This reinforces the need to word the initial disclosure carefully to ensure there is an appearance of 'there is nothing to see here, move along'.

If a voluntary disclosure is not made, and IRD find the error themselves the situation could be much worse. Shortfall penalties, that may not otherwise have been applied, could be charged and the IRD may undertake a more comprehensive investigation. So we would always recommend full disclosure at the earliest opportunity. Being able to sleep at night is worth some temporary discomfort.

Snippets

Sneezing colleagues



Modern workplaces are increasingly open plan, so sneezing colleagues are hard to miss during the flu and hay fever seasons. Many would be able to name one or two people with particularly loud or interesting sounding sneezes, but funnily enough research has found that the sounds made when people sneeze

are all for show.

The usual 'achoo' sound so many of us make when sneezing is specific to English speakers. The Japanese sneeze is a "hakashun", with Filipino's a "ha-ching", and the French making a "atchoum".

You might then wonder what sound a deaf person makes when they sneeze. Interestingly, their common sound is simply one of air escaping from their lungs. No achoo's, hakashun's or atchoum's - just a quick exhalation.

Researchers from University College London found that the sound and volume of a sneeze is modified depending on social acceptability. As deaf people have never heard the sneezing sounds of people around them, they sneeze how nature intended.

So next time the sneezing season comes round, listen in to how your colleagues sneeze – you might learn something interesting about their background.

Holding gold

Can an investment in gold bullion create a tax liability? Inland Revenue (IRD) has recently released a statement on this specific point.



IRD consider that gold bullion purchased as an investment has been acquired with the purpose of eventual disposal, i.e. a purpose or intention of resale exists. Consequently, any gain that arises on its future sale is income and taxable. In IRD's view, a commodity such as gold does not provide any annual return or income for the period of ownership, so it is hard to argue that the investment was for any purposes other than eventual disposal.

The IRD considers the 'reason' for acquiring gold is irrelevant. Whether it has been purchased as an investment, or a hedge, this does not counter the underlying purpose of a future disposal. In comparison with other investments such as shares in a company, which may be held on capital account for the purpose of a deriving a dividend stream, gold has none of these features.

Domestic Violence Bill

The Domestic Violence Bill 2017 (DVB) is currently before the Select Committee in Parliament.

This Bill has the potential to affect all employers – so if you are an employer you should take note of it.

A brief summary of the main provisions of the Bill that will practically affect employers if enacted as drafted are –

- (1) All employees will be entitled to 10 days paid domestic violence leave per annum. This is in addition to any other leave entitlements.
- (2) Affected employees will be able to request flexible working arrangements (e.g. place of work, days of work, hours of work, who they work with etc.).

These provisions could impose significant costs on an affected employer. Based on a 40 hour week and hourly wage of \$20 then a 10 day cost is \$1,600 plus any Kiwisaver entitlements plus the cost of replacement workers.

We question whether the burden of dealing with Domestic Violence should fall upon employers.

If you wish to have any influence on this Bill you should contact your local MP.

ACC Cover

Loss of earnings compensation is generally available to any working person who suffers a loss of earnings due to an accident. Generally, compensation commences 2 weeks after the accident and is for 80% of the loss of earnings on a weekly basis.

However, a lack of cover may occur in a number of circumstances, some of which may be –

- First year of self-employment.
- A self-employed person suffered a loss in the previous financial year.
- A shareholder employee of a company did not receive a shareholder salary in the previous financial year.

There may also be limitations on cover where a person is not in full time employment/self-employment.

In these cases, it may be possible to obtain cover either by way of purchasing cover direct from ACC (called Cover Plus Extra) or by obtaining insurance cover from an insurance company or broker. However, cover must be arranged in advance, i.e. before an accident occurs. It is too late to try to obtain cover after an accident has occurred!

Obviously cover comes at a cost. We have had experience of clients being very happy to have no ACC levy but then being upset when they have an accident and find that they are entitled to no or limited compensation.

Please note that ACC only ever covers accidents and never covers illness. Sometimes it can be very

difficult to decide if something is the result of an accident or the result of an illness. If you wish to ensure that you are covered for everything then you need to obtain a suitable accident and illness policy from your insurance company or insurance broker.

If adequacy of cover may be of concern to you please contact either ACC (0800 222 776), your insurance company/ insurance broker or our office.

Audit Shield

As most of our clients will be aware we offer an insurance policy for the costs related to attending to any tax related audit enquiry from the Inland Revenue Department. This policy is called Audit Shield".

In the days of, threatened, increased audit activity by the IRD we believe that the policy is good value.

If Audit Shield may interest you and you are not currently a holder of the policy would you please contact our office so that we may forward details to you.

Festive Season

The end of the year is rolling around very quickly!

With regards to staff the year has been reasonably stable for us. The only change that we have had is that the receptionist we appointed at the beginning of the year did not work out and she left in the middle of the year. We subsequently employed Cindy who has been a pleasure to have in the office. Otherwise the staff consisted of Mark, Gail and Craig. Mark has now completed his examinations and is in the process of applying to become a Chartered Accountant. We expect him to complete this process in the first couple of months of 2018. Gail continues to work at her Bachelors of Commerce degree and has only a few papers to go. Hopefully she can complete these papers next year.

Our office will close for our annual holidays at midday on Friday 22 December 2017 and will re-open at 8-30am on Monday 15 January 2018.

Should you have an urgent matter upon which you need to contact us please contact Craig by either email (craig.hastie@hastieaccountants.co.nz) or on his cell phone (021 074 6261). Emails and calls will be cleared on a regular basis throughout the holiday period.

Finally, we take this opportunity thank all our clients for their custom during the year and wish everyone well for the festive season and New Year.



If you have any questions about the newsletter items, please contact us, we are here to help.