BIZTAX ALERT

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NEWSLETTER

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INSIDE THIS EDITION

Provisional Tax – what if you get it wrong?

You are probably aware that Inland Revenue allow you until 7 April of the following year to pay the balance of tax owing – just over a year of credit. Further, if your Income Tax liability for the year is under $60,000 IRD do not charge interest on this tax deferral.

However, this is subject to some provisos and the important ones are that:

- The Provisional Tax for the year has been based on the previous year's tax (the "safe harbour" option).
- All Provisional Tax calculated on this basis has been paid in full by the due dates.

If these conditions are not met, the whole year's tax is taken out of the "safe harbour" arrangement and the interest clock is started. The interest is not only charged on the late payment itself, but will be charged on the Terminal Tax which would not have been subject to interest had the above conditions been adhered to. The practical effect is that you can pay interest which is well out of proportion to the actual amount, or time, of the late payment.

Fortunately there is a remedy. This is in the form of purchasing tax credits through a tax pooling intermediary. We use Tax Management NZ (TMNZ) for this purpose. This allows you to retrospectively purchase a tax credit at an earlier date. This is then fed into the IRD system at the due date and is treated as being paid on time, thus restoring the interest free status of the remaining tax.

There is some interest payable to TMNZ but it is typically around 4.50 % pa (lower than IRD interest) with no further fees charged by them.

The key to effective use of TMNZ is to contact us when a short (or late) payment situation has occurred so we can establish payment through TMNZ. Do not make the payment directly to IRD. If this is done the payment will be recorded as late, with the consequences as set out above.

New trust annual return requirements

In December 2020 the legislation enacting the new 39% tax rate was passed. Within the same bill, somewhat overshadowed by the rate change, was the introduction of a new "annual return" requirement for trusts.

Not to be confused with the new Trustee Act that came into effect at the end of January which requires certain disclosures to be made to beneficiaries, the annual return requirement included in the December 2020 bill imposes the disclosure of various trust information to Inland Revenue on an annual basis.

As enacted, the annual return for trusts will comprise:

- an income statement and balance sheet;
- details of any settlements made on the trust during the year;
- the name, date of birth, country of tax residence and IRD number of any person who makes a settlement on the trust in the year, whose details have not previously been provided;
- details on every distribution made by the trust during the year, including capital distributions, as well as details on the recipient beneficiaries; and
- details of any person who has the power to appoint and remove trustees and beneficiaries of a trust.

The requirement will not apply to non-active, charitable or Maori authority trusts and foreign trusts that are already filing disclosures with Inland Revenue.

Although the legislation applies for the 2022 income year onward, there is a provision which allows Inland Revenue to request the same annual return information for any period between the 2015 and 2021 income years.

Inland Revenue is likely to use the information to monitor the extent to which income is being taxed to trusts at 33%, that would have been taxed at 39% if derived by individuals. That information could then be used as a basis for the Government to either increase the trust tax rate or increase the extent that beneficiary distributions are taxed to individuals.

The information could also be used by Inland Revenue to specifically check other areas of compliance. For example:

- Imputation streaming rules require dividends received by a trust that are then distributed to a trust's beneficiaries to be spread proportionately across those beneficiaries, otherwise imputation credits may be forfeited.
- Taxable income can be triggered if a trust receives the benefit of a debt forgiveness and a subsequent distribution is made to a corporate beneficiary.
- Application of the land taxing rules can depend on whether parties are associated. The level of disclosure will enable Inland Revenue to readily determine who a trust is associated to.

As time passes and the amount of information held by Inland Revenue increases, they could proactively identify errors in a trust's tax position. Especially if a trust has moved from one accountant to another and Inland Revenue has a clearer picture of past transactions than the new accountant has.

The 39% rate change

The top personal marginal tax rate increases to 39% on income over $180,000, with effect from 1 April 2021. Businesses should consider what the flow-on effects are and forward plan to ensure they are not caught off guard. Two key areas are discussed in this article.

Simplistically put, a company pays income tax at 28%. Imputation credits arise from that tax paid and are used to reduce the tax payable by shareholders when dividends are paid. Further tax may be payable by the shareholder if the tax liability on the dividends is more than the imputation credits.

If shares in a company are ultimately held by an individual, consideration should be given to declaring a dividend prior to 1 April 2021, in which case it will be taxed to the individual at 33% (rather than 39% to the extent income would exceed $180,000 from 1 April 2021).

This requires a comparison between the income tax liability that will be triggered upon declaring a dividend prior to 1 April 2021, versus the expected future income tax liability that will be triggered if a dividend is declared on or after 1 April 2021.

The FBT regime ensures tax is paid on non-cash benefits provided to employees, such as company vehicles and fuel cards. When calculating FBT, employers have the option of using one of the following methods:

2. The single rate option, where a single rate of 49.25% is applied to all benefits provided to employees.
3. The short-form alternate option, where rates of 49.25% and 42.86% are applied to attributed and non-attributed benefits, respectively. This appeals to employers who predominantly provide attributed benefits to employees who earn more than $70k.
4. The full alternate rate option, where a separate calculation is undertaken for each employee who has received attributed benefits with reference to each employee's salary. A rate of 42.86% is applied to non-attributed benefits. This appeals to employers who predominantly provide benefits to employees who earn less than $70k.

Typically, benefits that are subject to FBT are provided to higher-earners, and consequently, the 49.25% FBT rate under the default FBT method equates to the current top marginal personal tax rate of 33%, which keeps the FBT filing process simple.

The full alternate rate option takes considerably more time to calculate, and as a result, employers that value time and efficiency tend to use the single rate or short-form alternate rate option, irrespective of the cash savings that the full alternate rate can provide.

With the introduction of the 39% marginal tax rate, the 49.25% and 42.86% FBT rates will be increasing to 63.93% and 49.25% respectively from 1 April 2021. This effectively means employers that use the single-rate option will be paying FBT as if all employees earn more than $180,000, when in reality the 39% rate is expected to apply to only 2% of New Zealanders. As a result, employers may wish to consider undertaking the short-form or full alternate rate calculation from 1 April 2021, as the cash saving may exceed the additional time and effort.

In the lead up to the 2022 financial year, companies should be exploring different options to ensure tax efficiencies are achieved.

Directors' duties

Company directors have a duty under the Companies Act 1993 to not trade recklessly or take on obligations that their business cannot perform. Balancing the continued survival of a company versus their obligation against reckless trading has been a key feature of the Covid-19 economic environment.

Recognising that the economic impact of Covid-19 placed some companies in temporary financial distress as they adjusted to their new trading environment, amendments were made to the Companies Act 1993 for the benefit of directors.

The amendments provided safeguards for company directors enabling them to take a longer term view of a company's ability to trade. However, those safeguards ceased from 30 September 2020, so directors need to revert to the more stringent approach required prior to the amendment.

In a timely reminder of directors' duties, the recent Supreme Court decision Madsen-Ries v Cooper [2020] illustrates when the actions of directors will be in breach of their duties.

Mr Cooper was the sole director of Debut Homes Ltd (Debut) a residential property developer. In 2012 Debut owed Inland Revenue more than $300k of GST, amongst other creditors. Mr Cooper was advised by his accountant that these debts were insurmountable.

However, with 6 properties under development, Mr Cooper persisted in expectation of the profit from their sale. Additional finance from third parties, guaranteed personally by Mr Cooper, and a loan from his family trust, were used to complete the properties and pay secured creditors. However, no GST was paid to Inland Revenue on the sale of the 6 properties, adding to the GST liability already outstanding.

Finally, in March 2014, Debut was placed in liquidation by Inland Revenue with a GST liability exceeding 500k (including interest and penalties). The High Court held that Mr Cooper breached his duties under the Act by continuing to trade in a manner that benefited some creditors but was detrimental to others.

In September 2020 the Supreme Court restored the High Court's orders and allowed the appeal by the liquidators. The actions of Mr Cooper amounted to reckless trading and a breach of a director's duty to not enter obligations on behalf of the company where there was no intention or ability for the company to meet those obligations. Mr Cooper will likely be personally liable for some or all debts of the company and potentially barred from being a director.

Perseverance has been key to survival for many businesses during COVID-19. However, continuing to trade with the belief that a business will be profitable, while ignoring the reality of the balance sheet risks directors breaching their professional duties.

Snippets

COVID support packages

While we have enjoyed relative freedom in New Zealand, the Government has continued to work on Covid-19 support packages.

The COVID-19 Leave Support Scheme allows those who have been told to self-isolate, to receive two weeks income if they are unable to work from home. In addition to this scheme, from mid-February 2021 a Short-Term Absence Payment will be available for those who need to stay at home while awaiting a COVID-19 test result.

The Business Finance Guarantee scheme can be applied for until 30 June 2021 and allows small and medium sized businesses access to up to $5 million to support operating cashflow and asset purchases, as well as helping respond or recover from COVID-19. This scheme is supported by the Government so if the business defaults on the debt the lender can claim 80% of the defaulted debt from the Government.

Applications remain open until the end of 2023 for the Small Business Cashflow Loan Scheme, which allows organisations that employ 50 or fewer employees that have been adversely affected by COVID-19, access to a one-off 5-year loan. Organisations can draw down up to $10,000, plus an additional $1,800 per employee. No repayments are required for the first two years, however, following this the interest rate increases from 0% to 3%.

Until April 2022, the Apprenticeship Boost Initiative will be available to support employers of first and second year apprentices. The amount of funding received a month depends on when an apprentice started their training. Employers can use the funding to top up apprentices' wages to at least the minimum wage.

The various wage subsidy schemes can no longer be applied for. These are only put in place if the Alert Level increases to Level 3 or 4 for 7 days or more, so hopefully we don't see these again.

Office worker crimes

We have likely all heard about white collar crimes, where financially motivated nonviolent crimes such as embezzlement are committed by high profile business people. However, crimes, committed by office workers in low-to mid-level positions who steal money from their employers, have been on the increase.

One of the largest instances was in Singapore where an accounts clerk embezzled more than $46 million over 7 years by depositing business cheques into a personal account used to fuel a gambling habit.

In New Zealand a McDonalds Manager stole $166,000 as she was able to authorise cash refunds to customers. It wasn't until an internal audit disclosed the disproportionally high amount of refunds paid out when the particular manager was on duty, that she was apprehended. Further examples include an accounts clerk paying herself just under $90,000 in wages in a 12-week period and a casino worker stealing $45,000 in gambling tokens in the space of one month.

Does this mean that the innocent accounts clerk, bookkeeper or manager may not be as innocent as we all think? Well potentially. Companies continue to invest large amounts of money into anti-fraud systems and in some cases even have teams in place to detect such occurrences. So how does this go unnoticed? A couple of hundred dollars here and there can be harder to spot, but eventually adds up.

Given that not all employees are 100% trustworthy, businesses should take measures to minimise the opportunity for theft by those within the organisation. The extent of these measures will be dictated by the size of the organisation but sometimes simple measures such as ensuing one person is not involved in all aspects of a process, and rotating duties from time to time, can help.

And don't forget to just look out the window and ask yourself, how does your employee afford the insurance on their Ferrari?

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