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The Client Link

July 2005

Repairs & Maintenance to the Depreciation Rules

The government has announced further changes to the depreciation rules. The key features of the proposed amendments to the current tax depreciation rules are:

- The depreciation rates on shorter-life plant and equipment will increase, with no change to depreciation rates for longer-life plant and equipment. Examples of these new rates include:

	Old Rate	New Rate
Computers	48%	60%
Appliances	31.2%	36%

(All rates use the diminishing value method and include the loading).

These new rates will apply to Assets acquired on or after 1st April 2005. However, it is important for late balance date (balance dates ending in April – September) taxpayers to note that the new rates will not apply until the 2005/6 income year.

- The depreciation rates for buildings will decrease.

This will apply to residential rental properties and commercial buildings. The diminishing value rate of depreciation will drop from 4% to 3% on Buildings acquired from 19th May 2005.

- The compliance costs associated with the current depreciation rules will be reduced by increasing the threshold for low-value Assets. The immediate deduction allowed for low-value Assets will increase from \$200 to \$500. This is a major compliance concession which the government is providing to businesses in relation to low value Assets. This new threshold applies to purchases on or after 19th May 2005.
- It has been clarified that a full deduction is available for costs associated with disposing of Assets.

Income Protection Insurance

Many clients have income protection insurance policies but many will not know how good they are until the unfortunate time of having to make a claim.

- Tax treatment of Agreed Value policies is unsure. Some insurers say that any benefit will be taxable income and so the premium is deductible. These insurers will allow you to cover up to 75% of income. Other insurers say that the benefit is not taxable and the premium non deductible. These companies only allow you to cover 55% of income. What happens if IRD says the 55% is taxable. You will be underinsured.
- Even “agreed value” policies will offset any on-going income you receive.
- Does the policy have a guaranteed right of renewal until age 65? Can the insurer cancel the policy?
- How long will the company pay out if you have a long-term disablement? Do not accept a policy that specifies a period.
- What about partial disablement? Do not accept a policy that does not have a benefit payable if you are partially disabled. Again ensure there is no fixed term on partial disability claims.
- What is the position on mental health claims for stress & depression, two of the largest causes of claims. Are they included? Is there a limited period?
- Beware of policies that allow the insurer to deem that you are earning if you are medically able to work. Policies should be own occupation.

Value of Fringe Benefit—Vehicles (starts 1 April 2006)

We will be able to choose between paying FBT based on 20% of the GST inclusive cost of the vehicle each year or on 36% of its diminishing value. The diminishing value method has a minimum value of \$8,333 exclusive of GST. Tax book value is the same as the depreciated value.

9 to 5 Leases or Flip Leases

These leases with an employee including a shareholder employee will now be subject to FBT. Expect the demise of the 9 to 5 lease.

IMPORTANT: This is not advice. Clients should not act solely on the basis of the material contained in **The Client Link**. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. **The Client Link** is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.

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Transfer of Depreciable Property Between Associated Persons

When a property is transferred between two people who are associated, eg a shareholder sells company property to his family trust, the taxpayer acquiring the property is usually allowed to claim depreciation on the original cost of the property to the associated vendor. However, the Commissioner has discretion under section EG 17 of the Income Tax Act 1994 to allow depreciation on the actual cost to the purchaser if he deems such treatment as "appropriate", ie if it creates an unfair disadvantage to the taxpayer.

The Commissioner will consider the following factors when determining whether the circumstances are "appropriate" before using his discretion:

- Whether the transfer is genuine/bona fide;
- Whether the transfer price is at no more than market value;
- Whether there is permanent transfer of legal ownership of the property;
- Whether the associated vendor continues to benefit directly or indirectly from the transferred property, ie through:
 - control over the associated purchaser; or
 - a leaseback or similar agreement; or
 - continued use of the transferred property for income-producing purposes; and
- The commercial (non-tax) reasons for the transfer of the asset.

The above factors would help the Commissioner to avoid a situation where one taxpayer gains an unfair advantage by benefiting from a higher depreciation deduction over other taxpayers who are in a similar situation but unable to dispose of their property to associated persons.

This discretion cannot be exercised as of right, but only in response to a written application to the IRD from the purchaser. The application must be lodged *before* the potential transfer of property takes place, and should be supported with evidence that the transfer is based on genuine commercial reasons.

A case of interest is *CIR v Lys & Others* where the taxpayers, Mr and Mrs Lys, were trustees and Mrs Lys was also a beneficiary of a family trust. Mr Lys transferred his farm property to the family trust at fair market value, and claimed depreciation on the building on the indemnity value determined by the insurance company for fire insurance purposes. The sale value was greater than the cost of the assets. As a result, the depreciation claim was three times that which had been claimed by the vendor before the property had been transferred. The Commissioner reduced the depreciation claim and taxed the trust for any additional income from the adjustment. The case was appealed and the High Court found in favour of the taxpayers, maintaining that the Commissioner should have instead exercised his discretion under the Income Tax Act 1994.

Kids Wages (start 1 April 2006)

The child rebate increases from \$156 to \$351 or wages of \$1,040 to \$2,340. The rebate does not apply to interest or dividend income. But it does to rents?

Cash flow Positive Moves with Provisional Tax

In a move which is intended to reduce compliance costs for businesses, the government has introduced legislation to align the payment of GST and Provisional Tax. This provides a deferral from when Provisional Tax payments are currently due with the last payment date arising after the end of the income year.

Currently, provisional tax payments are due on the 7th day of the 4th, 8th and 12th months in an income year. Under the proposals the payments will be made on the 28th day in the 5th, 9th and 13th months after the start of the income year.

This applies to all taxpayers unless they can and do opt into the "GST Ratio method" calculation Provisional Tax based on GST returns and/or electing to make six payments per year.

Under the "ratio method" taxpayers can use their GST returns as the basis for determining the Provisional Tax payments due. They will effectively pay Provisional Tax based on the previous years' residual income tax Liability however, the payments are spread throughout the year based on the level of taxable supplies per the GST returns. These taxpayers will be exempt from use of money interest in respect of their provisional tax payments.

The Provisional Tax reforms have a phased implementation:

- Those GST registered taxpayers whose GST taxable periods are not aligned with their income tax balance dates will start being aligned from 1 April 2006.
- The due date for payments of GST will change from the last working day of the month to the 28th of the month, with effect from taxable periods ending on or after 31 March 2006.
- Provisional taxpayers will begin paying provisional tax along with their GST payments. They will also be able to base their Provisional Tax on a percentage of their GST sales with effect from the beginning of the 2007-08 year.

The loss of two or three days to complete GST returns will make it difficult to complete all GST returns in those months. This is especially so as GST returns will be more concentrated around business and farming balance dates of 31st March and 31st May, and have to complete six GST returns per annum is opting for this method.

Direct Credit Payments

Many thanks to all clients who pay their accounts electronically. This certainly speeds up the processing of your payments and avoids cheques getting lost in the post. There are instances where clients are paying more than one Account electronically. It is important to include some form of identification, such as invoice numbers in one of the reference fields. If you have any queries in relation to electronic banking, please contact Sarah Wallbank to arrange such payment.

