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NSA ON TAX

UNCERTAINTY REIGNS IN TAX LAW

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Yesterday the Government introduced the Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill. At present, only the commentary to the Bill is available on the IRD policy website (www.taxpolicy.ird.govt.nz).

Motor Vehicles & FBT

The commentary identifies retrospective changes to the fringe benefit tax treatment of vehicles which were subject to lease prior to 1 April 2006. The relevant clauses in the Bill are clauses 115 and 131, but as noted we have not been able to review those clauses yet. The Bill summarises the proposed amendments and notes that "...in general, vehicles acquired before 1 April 2006 should be subsequently valued at cost;".

As far as we can tell, the effect of this will be that vehicles which were subject to 9-5/Flip leases prior to 1 April 2006 and which are brought into the FBT net after that date, will be subject to FBT based on their cost price. Where the vehicle was or is leased from an associated person, the cost price will be the cost price to the associated lessor.

For example, assume a client acquires a new \$60,000 vehicle (GST inclusive) on 1 April 2004

which has been subject to a Flip lease with his company since that time. The tax book value of the vehicle to the individual lessor would be \$28,400, assuming a 31.2% DV rate has been applied. Where the 9-5 Lease is left in place between the individual and employer/company post 1 April 2006 (as we have recommended on many occasions), or the vehicle is sold to the employer, an FBT liability will arise from 1 April 2006.

Based on the legislation as currently drafted, the employer would be obliged to calculate FBT based on the "tax value" of the vehicle, being \$28,400. However, under the proposed changes, in this circumstance FBT will be charged based on the historical \$60,000 cost price, potentially increasing FBT from \$6,536 per annum to \$13,809, an increase of \$7,273 in the first year.

This change is retrospective in that it applies to fringe benefit tax periods beginning on or after 1 April 2006.

The retrospective amendments to the legislation mean that much of the planning which has taken place prior to 31 March is now defunct. Assuming this law change goes through (and there is no reason to believe that it won't), this fundamentally changes our

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recommendation in relation to motor vehicles which were subject to 9-5/Flip leases prior to 31 March 2006.

As we have noted in previous NSA on Tax Newsletters, we find the haste and lack of thought that has gone into enacting this legislation nothing short of appalling. Certainty of application of tax laws is a fundamental tenet to the successful operation of any tax system which relies on voluntary compliance. This type of legislation "on the hoof" does nothing to encourage taxpayers to meet their obligations in an honest and timely manner. The Government is seemingly unconcerned with the impact this change has had on thousands of taxpayers.

The Government has had since 19 May 2005 when the original Bill was introduced to clarify the law. The latest proposed change is an absolute joke. The Government claims this is a "clarification" of the law. This is utter rubbish. The law as enacted on 3 April 2006 is crystal clear in its application. This change is a fundamental alteration to the calculation of FBT as envisaged by the original Bill and amending Act.

We will in due course be reviewing our motor vehicle package and issuing a more in-depth analysis of the changes (once we have actually seen the legislation) to those who purchased that package. Further comment will no doubt be made in future editions of this Newsletter.

Offshore Portfolio Investments & Other Proposals

As expected, the Bill also introduces the proposed changes to the taxation of offshore portfolio investments under the foreign investment fund ("FIF") rules.

This proposal is fast becoming a fiasco. In our view, the proposal is the "thin end of the capital gains tax wedge". It is nothing more than the genesis of a broad based capital gains tax regime. We have already had a number of our clients who are relatively new migrants or returning residents seriously contemplating moving offshore due to the disincentives the current Government continually introduces (just ask Telecom shareholders what they think of the Government arbitrarily removing proprietary rights).

We look forward to a healthy debate on this issue, the no doubt numerous submissions which will be made against this proposal and hopefully a Government "back track".

That said, there is still the prospect of Dr Cullen's "chewing gum" tax breaks in 2008 (if there is anyone left in New Zealand to enjoy them).

Author: Philip Bell