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NEWSLETTER

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GST and Time of Supply

The Inland Revenue Department issued a draft interpretation statement, IS0092, in May 2005 signalling a change of policy by the IRD on whether or not an unconditional sale and purchase agreement constitutes an “invoice”, thereby triggering the time of supply for GST purposes. The closure date for submissions on the draft was 30 June 2005.

Generally, the time of supply for GST occurs at the earlier of an “invoice” being issued or any payment being received by the supplier. An invoice is defined for GST purposes as a document notifying of an obligation to make payment. The Inland Revenue Department’s previous policy was that for property transactions, a sale and purchase agreement that was unconditional from the date of signing constituted an “invoice”. Therefore, the time of supply was the date the agreement was signed. This view was accepted in practice, although there were concerns that it was not a correct reflection of the law.

The Inland Revenue Department has reviewed its policy in the light of comments made by Richardson J in the Court of Appeal decision of Shell New Zealand Holding Co Ltd v CIR on what constitutes an invoice for GST purposes. In particular the draft policy applies these comments to the standard Auckland District Law Society / Real Estate Institute of New Zealand sale and purchase agreement (standard agreement). The conclusion reached is that it is very unlikely that the standard agreement, even if unconditional from the outset, would constitute an invoice.

There is no change in the draft statement in relation to the Inland Revenue Department’s interpretation of when the time of supply is triggered for conditional contracts that later become unconditional. The draft confirms that these contracts can never constitute an “invoice” for GST purposes and therefore never by themselves, trigger the time of supply.

Practically, an unconditional contract will typically be accompanied by the payment of a deposit. If the supplier receives a deposit, the time of supply will be triggered regardless of whether the sale and purchase agreement constitutes an invoice.

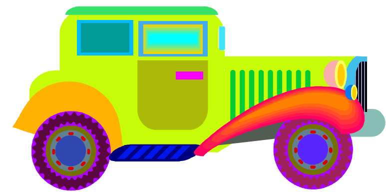
Keep in mind the deposit does not have to be physically received by the supplier, it is sufficient for it to be applied for the benefit of the supplier, eg application of the funds to legal or real estate agent fees. Further if the deposit is held by a "stakeholder" it has not been received by the supplier and will not trigger the time of supply, eg the deposit is held in the solicitors trust account.

On a related note, the IRD has also confirmed its position on GST and cancelled land contracts previously outlined in an exposure draft.

When an agreement for sale and purchase is cancelled the GST effects of the contract will be reversed in the period in which the agreement is cancelled. In periods prior to the cancellation of the contract, GST must be accounted for in the normal way. This is regardless of whether it is known at the time of filing the particular return that the contract is cancelled. By way of explanation, take the situation where a vendor of property is registered on a two monthly invoice basis with a period end of 31 March 2005. Assume the time of supply for the property sale was 28 March 2005 and the contract fell over on 3 April 2005. Under the rules the vendor will still be required to return the full amount of GST under the contract in their February/March GST return. A credit for this amount will then be claimable in the April/May GST return.

Further, where a deposit is retained by a vendor after the cancellation of a contract, the payment is compensation and does not relate to the original supply under the contract. In these circumstances the compensation is liquidated damages, which is not a supply for GST purposes. Accordingly there is no GST returnable or claimable in relation to retained deposits arising from the cancellation of the agreement.

Fringe Benefit Tax (FBT)



The proposed changes to the FBT regime currently making their way into law albeit now in limbo (see page 4) have already received considerable attention and analysis. The changes are scheduled to take effect from 1 April 2006, no transitional provisions have been included. A number of opportunities have been closed off although some new opportunities to provide benefits to employees will become available.

Vehicles

Employers will have the option of calculating the value of a motor vehicle benefit based on either the cost price or tax (depreciated written down) value of a vehicle. New rates apply depending on the method adopted: to determine the value of the fringe benefit with

- Where a vehicle is leased, rented or owned, jointly or otherwise, and the cost price of a vehicle to the owner is used, the rate of 5% (quarterly) or 20% (yearly) will apply.
- Where a vehicle is leased, rented (whether associated or not) or owned, jointly or otherwise, and a vehicle's tax value is used, the rate of 9% (quarterly) or 36% (yearly) will apply. The minimum tax value of a vehicle that can be used is $8,333.
- Aligning leased vehicles with owned vehicles removes the advantage currently available from using 1 by 1 leases. Current flip leases (sometimes referred to as 9 – 5 leases) have also been rendered void for FBT, you may wish to consider further options (e.g. direct reimbursement), became if these leases are still in place on 1 April 2006, FBT will apply on the original cost.
- Due to the different rates applicable to each valuation method, a higher FBT cost will be incurred under the depreciated valuation method in the first two years compared to the cost method. Over a five year period the total cost under each method is basically the same. In order to stop taxpayers taking advantage of the mismatch by switching from the cost method to the tax value valuation method at year three, the valuation method used in a vehicle's first FBT return has to be used for a minimum five year period.
- It is considered that, unless it is certain that a vehicle will be owned in excess of 5 years, it would be best to start with the cost method and switch to the valuation method after the initial five year term. That way the client will not be penalised if he were to sell that vehicle earlier than expected.
- The need for a review of the definition of "work related vehicle" had been identified in the discussion document leading up to the Bill, but no change has eventuated.

Other Fringe Benefits

Benefits provided by charities will no longer be exempt where they are provided by a short-term credit facility such as a credit card. However, the value of the benefit has to be more than 5% of the employee's salary for a taxable fringe benefit to occur.

The FBT exemptions for unclassified benefits will be raised from $75 per employee to $200 per

employee per quarter and $450 per employer per quarter to $15,000 per employer for the last four quarters including the current quarter.

For employers accounting for fringe benefit tax on an annual or income-year basis the exemptions have been raised from $300 per employee per year and $1,800 per employer per year to $800 and $15,000 respectively.

A business tool provided to an employee mainly for business use valued at under $5,000 will not give rise to a fringe benefit. This includes items such as laptop computers and cell phones. If the item is also used privately a fringe benefit will not arise, as long as the primary business use test is satisfied.

When a seconded employee returns home to visit family, the travel costs incurred by the employer will be exempt from FBT. The legislation will be amended to ensure when an employer provides for a family member to visit the employee the benefit will also be exempt. It is intended to make sure the treatment under each scenario matches the other by limiting the value of the exemption to the cost that would have been incurred if the employee had travelled home.

A fringe benefit will no longer occur where an employer secures an arrangement from a person through which goods or services are provided at a discount. The exclusion will apply where the person offers the same discount to a similar sized group of persons on an arms length basis, in these cases the goods or services are to be treated as being a supply to the public on ordinary terms.

We will provide updates as the Bill works its way through the House.

Employee or Independent Contractor

The outcome of the final hearing in a long running case about whether the applicant was an employee or an independent contractor has important implications for employers and their advisors.

Facts

In April 2000 Mr Bryson was seconded from Weta Workshop Limited where he was an employee, to work for Three Foot Six Limited (3F6) in its miniatures unit, which was filming special effects for the Lord of the Rings project. At the end of the two week secondment period, he was offered a permanent position with 3F6. Mr Bryson agreed to work directly for 3F6 after first agreeing on his hours of work. Mr Bryson was not given an employment contract when he began. For the first few weeks he received training. In October 2000, 3F6 supplied a written contract for all its crew which refers throughout to "contractor" and "independent contractor", Mr Bryson signed the contract. Mr Bryson was paid weekly after submitting an invoice of hours worked. As a result of downsizing Mr Bryson was made redundant at the end of September 2001 and he alleged unjustifiable dismissal. In order to bring such a claim Mr Bryson had to have been an employee.

Section 6 of the Employment Relations Act 2000 defines "employee". The courts have applied the following principles in applying the definition:

- The court must determine the real nature of the relationship.
- The intention of the parties is still relevant but no longer decisive.
- Statements by the parties, including contractual statements, are not decisive of the nature of the relationship.
- The real nature of the relationship can be ascertained by analysing the tests that have been historically applied such as "control", "integration", and the "fundamental" test.
- The fundamental test examines whether a person performing the services is doing so on his/her own account.
- Another matter which may assist in the determination of the issue is industry practice although this is far from determinative of the primary question.

Decision

In April the Supreme Court restored the earlier decision of the Employment Court. In the Employment Court, Judge Shaw found that, despite the signed contract for services and payment being made upon invoice, the real nature of the relationship was that of a contract of service (employment). The Judge stated that there was no evidence that Mr Bryson was acting as a separate business entity which contracted independently with 3F6. He had not tendered for his position and he had accepted an offer from 3F6. Also, it was not a short term position and he had no other employment while with 3F6. Although Mr Bryson had had previous experience, as he had required six weeks training it could not be said that he had contracted his skills to 3F6. Mr Bryson was expected to work at the direction of 3F6 and his time was not his own. Elements of the contract signed by Mr Bryson reflected that of an employment agreement not a contract for services.

It remains to be seen if Mr Bryson is successful in his case for unjustifiable dismissal. The same principles apply for tax purposes. This case emphasises that employers must be extremely careful when determining whether a person is an employee or contractor.

Grassing and Fertiliser Expenditure

An interpretation statement was issued by the IRD in July 2004 setting out how expenditure incurred on farm conversions was to be treated. This interpretation statement was commented on in the November/December 2004 issue. The statement required grassing and fertilising expenses associated to a farm conversion to be capitalised and then amortised.

Reaction from farmers and accountants questioned its appropriateness as the expenses would have to be capitalised and depreciated at a rate of 6% which did not reflect the reality of modern farming practices. Changes included in a recent Bill have clarified the rules and gone some way to meeting the needs of farmers. The legislation will clearly allow a deduction for re-grassing and fertilising expenses will be immediately available unless the expenses have been incurred in connection with a significant capital activity such as a farm conversion and the pasture has an estimated useful life of more than one year. If grassing and fertilising expenses are required to be capitalised, the depreciation rate has been increased to 45%.

The original rules have survived the amendments. Where grassing expenses are incurred in preparation of land for farming or agriculture the expenditure is to be capitalised and depreciated at the rate of 6%.

Little Snippets

Bill Enacted

The Taxation (Base Maintenance and Miscellaneous Provisions) Bill 2005 received Royal Assent on 21 June 2005. Among the changes included in the Amendment Act is the requirement for excess imputation credits received by individuals and unincorporated bodies to be carried forward as opposed to being converted to a net loss. As marginal tax rates can vary the current rate of conversion was resulting in benefits for some taxpayers. The change will apply from the 2005 – 2006 tax year.

The Amendment Act introduces statutory privilege for tax advice provided by chartered accountants and other tax advisors approved by the IRD. The right of non disclosure belongs to the taxpayer and not the advisor. Where an information demand is received and the non disclosure right is to be claimed the IRD must be notified using an IRD form for this purpose (IR519). If the IRD requires disclosure of tax contextual information, a separate form (IR520) is to be completed. The right of non disclosure applies to information requests made from 21 June 2005 regardless of when the document was written. ICANZ has been approved by the IRD as an approved advisor group, meaning tax advice given by its members is covered by the privilege rules.

Tax Bills Not Enacted

Due to the dissolution of Parliament for the general election, two tax bills that had been introduced but not yet enacted, lapse. They include the new FBT rules to apply from 1 April 2006, so it is presumed that they will be reintroduced and enacted before then should the Labour Government be returned for a reward 3rd term. God forbid I hear some yell!

Abolition of the "Grey List" is not required!

For those equity investors in grey listed countries I suggest you put in your submission by 30 September 2005. Visit the NZ Shareholder Society Website (www.nzshareholders.co.nz.) to download their skeleton submission and put your name to it. This is the only way that the History Doctor of Finance will get the message that we don't want or deserve a tax on unrealised capital gain on equities resident in "grey listed" countries.

Rumour has it that Dr Cullen was so irked over the tax-free return from the sale of non-taxable bonus units in Australian unit trusts that he got into a rage and asked Treasury for this "pay-back".

If you have any questions about the newsletter items please contact me, I'm here to help.