



## WEEKLY COMMENT: WEDNESDAY 2 MAY 2012

### Introduction

1. Good morning! Welcome to my first 'Weekly Comment' on what's been happening in the tax world in New Zealand.
2. This is not a substitute for my 'Views on News', which I plan to maintain as a periodic complete round-up of events in New Zealand tax. However, 'Views on News' will only be issued once every few months (as has been the case so far), and will include references to the relevant updates in the website sections.
3. 'Weekly Comment' will be about important happenings and tax issues that I have been reading and thinking about. The details may not be currently available in my website sections, but the sections will be updated to include them in due course.
4. Today's topics are:
  - Main changes in the International Investment tax bill which now awaits Royal assent.
  - The officials' issues paper on *Recognising salary trade-offs as income* released on 18 April.
  - A paper I presented on 20 April on the new (and existing) FIF rules.

### International investment tax changes

5. The bill passed its final stages in Parliament yesterday. Details of all of the FIF changes will be included in a new website section on FIFs in the next few weeks. Most of the other changes are already referred to in 'Views On News' articles and the corresponding website sections. Some of the main tax changes are as follows:
  - (a) A raft of changes to the FIF rules, most of them applying from the first income year commencing on or after 1 July 2011:
    - Changes to the calculation methods: repeal of the Accounting Profits (AP) method; replacing the Branch Equivalent (BE) method with the Attributed FIF Income (AFI) method.
    - Changes to the choices between methods: Fair Dividend Rate (FDR) method becomes the default method available for non-portfolio as well as portfolio interests; Comparative Value (CV) method not available to anyone other than individuals and family trusts for FIF interests other than non-ordinary shares; Deemed Rate of Return (DRR) method unavailable except if CV cannot be used for non-ordinary shares; AFI available for non-portfolio interests and limited

availability for portfolio interests – the CFC active income exemption can be accessed by use of AFI.

- Changes to the exemptions: removal of the grey list exemption for non-portfolio interests, and replacement with an Australian resident FIF exemption; introduction of the active income exemption accessed through using the AFI method; extension of the new residents' accrued superannuation exemption to include all rights accruing on interests acquired before NZ tax residence; new exemption for FIFs held by insurance CFCs if a determination is issued; removal of the CFC exemption (i.e. FIFs that are CFCs) for PIEs.

(b) A number of changes to the thin capitalisation rules affecting outbound companies and trusts:

- The rules now apply to companies and trusts with non-portfolio interests in Australian resident FIFs or FIF interests for which the AFI calculation method is used.
- Introduction of the 'interest-income ratio' threshold test (and corresponding exemption) available retrospectively for income years beginning on or after 1 July 2009.
- Extension of the on-lending concession to include loans to non-residents who derive non-resident passive income.

(c) Some other changes:

- Removal of Approved Issuer Levy (AIL) for a select group of foreign securities.
- Prohibiting Qualifying Companies (QCs) from holding non-portfolio non-attributing FIF interests.
- Changing the foreign dividend exemption consistent with the FIF changes.

6. The final version of the Bill can be accessed at:

<http://www.legislation.govt.nz/bill/government/2010/0227/latest/DLM3324004.html>

### **Recognising salary trade-offs as income**

7. The paper contains proposed changes to income tax, FBT, GST and family scheme income (which affects tax credits related to social assistance) with a proposed application date of 1 April 2014.
8. While it is stated that fairness is the objective, the effects will be a significant reduction in FBT exemptions, GST output tax (for non-profit bodies) and reduction of Working for Families tax credits and other forms of social assistance. My feeling is that the basis for the concept of fairness espoused in the paper – that if "A" is taxed, so must "B" – is questionable. Individuals base their choices, including their employment choices, on a whole host of factors, a number of which cannot be assigned a monetary value.
9. What will happen upon implementation is that government revenue will increase and government expenditure will decrease. The result will be to tax, and include in family scheme income, all benefits for which salary has been traded off. There will also be significant compliance costs.

10. “Salary trade-off” will include:

- (a) Explicit trade-offs: All salary, wages, and other employment income payable in money that is traded off for non-cash benefits.
- (b) Implicit trade-offs where currently attributed or currently untaxed benefits are provided to a group of employees (e.g. on-premises car parks for managers) without a cash alternative, if the employees have an enforceable right, take up the benefit and the benefit is available.

11. Charitable organisations and non-profit bodies would have to register for FBT and charge GST on private benefits.

12. Whether the changes affect income tax or FBT will depend on how the salary trade-off rule is applied. The suggestions are to either tax all salary trade-offs in the hands of employees through PAYE, or widen the ambit of FBT. The changes proposed are as follows.

13. Income tax changes – the following would be taxable in the hands of employees if benefits are made subject to PAYE (similar to the current accommodation benefit):

- (a) Car parks and childcare provided on an employer’s premises that are part of a salary trade-off, valued at employment income traded off for the benefit(s).
- (b) Other benefits (not specified in the paper) already subject to FBT, if they are traded off for salary and covered by the new rules.
- (c) All benefits traded off for salary by employees of charitable organisations, valued at employment income traded off for the benefit(s).
- (d) Implicit trade-offs, with submissions sought on valuation, a suggested value being the amount the employer might pay a third party to provide the benefit.
- (e) A minimum value threshold of \$1,800 is suggested for aggregate salary trade-offs involving what would be unclassified or exempt benefits under the FBT rules (which equates to the FBT threshold for unclassified benefits of \$1,200 at a maximum FBT rate of 49.25%).

14. FBT changes: these would apply specifically to vouchers and more generally if the changes are introduced through a widening of FBT:

- (a) Exclude all car parks and childcare facilities from the on-premises FBT exemption and subject them to FBT to the extent they are part of a salary trade-off.
- (b) Apply the salary trade-off approach to non-cash benefits provided to employees of charitable organisations
- (c) Specifically exclude all arrangements involving vouchers from the FBT exemption for employees of charitable organisations. ‘Voucher’ will be widely defined so as to include, for example, a prepaid phone card facility.

15. GST changes: GST output tax will be payable on all private benefits provided by a non-profit body to its employees.

16. Family scheme income changes:

- (a) Include all fringe benefits that form part of a salary trade-off (currently only fringe benefits provided to shareholder-employees holding 50% or more of their respective companies are included). Three options are canvassed, with the preferred option being to include only benefits that form part of a salary trade-off.
- (b) Include all short-term charge and voucher facilities (not just when they are part of a salary trade-off or received by an employee of a charitable organisation).

17. Additional compliance requirements:

- (a) If the PAYE approach is used, an “FBT square-up” will be required, as the salary trade-off amount (net of PAYE) will be treated as an employee contribution towards the provision of the fringe benefit. Changes will be required for benefits currently subject to FBT that become subject to PAYE. New calculations will need to be done, including those involving the minimum value threshold.
- (b) If the FBT approach is used, the salary trade-off rule would be targeted on currently FBT exempt benefits. Employers will need to determine and advise employees of the value of all salary trade-off benefits for inclusion in family scheme income. This information may be required during the year and at year-end. Charitable organisations would need to put FBT systems in place.

18. The issues paper can be accessed at:

<http://taxpolicy.ird.govt.nz/publications/2012-ip-salary-tradeoffs-income/overview>

**FIFs paper presented at the Value Investors’ Conference**

19. Friday before last I presented a paper on the impact of the FIF rules mainly on foreign shareholdings to a group of interested (yes!!!) and intelligent investors at a conference organised by a wealth manager. I discussed the new rules and the calculation choices available. However, the paper was written with the non-technical audience in mind. I plan on including a comprehensive new website section on FIFs within the next few weeks.
20. A copy of the presentation and the paper is separately attached.



Arun David  
Director, DavidCo Limited