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## FUTURE TAX CHANGES

The IRD and the Treasury have released a Taxation of Savings and Investment Income report outlining potential tax reforms that could improve NZ's economic performance. Although changes in the near future are unlikely, it is an interesting gauge of what changes could be made in the longer term. Some notable highlights have been summarised below.

### CAPITAL GAINS TAX

Interestingly, the Treasury and the IRD are at odds regarding whether or not a capital gains tax should be implemented. The document states that the Treasury favours a capital gains tax, as it believes that this tax will raise revenue and at the same time increase efficiency. However, the IRD are of the view that the practical disadvantages resulting from implementing a capital gains tax regime will outweigh any benefits in the near future.

### CAPITAL INCOME TAX

Another proposed idea is a reduction in the tax rate that applies to income from capital. The reduced rate would apply to investments such as interest on bank deposits and investments into the PIE regime. The regime would also be relaxed to remove the requirement for an investment to be held in a managed fund.

Cutting tax on interest income (for NZ residents) is favoured as it is perceived to have the biggest impact on savings. But the concern is the distortions it may cause as a result of debt funding being more attractive than equity. Preference over debt is also seen as something that could chip away at financial stability.

### COMPANY TAX

Because of NZ's relatively high level of foreign capital ownership, a reduction in the corporate tax rate is not recommended. It is acknowledged that New Zealand's corporate tax rate needs to be in line with overseas jurisdictions to make sure New Zealand is in a position to compete globally. But dividends paid by companies to non-resident shareholders are typically not subject to



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New Zealand's top personal marginal rate of 33%, which normally applies when a dividend is paid to a NZ resident shareholder. This ultimately leads to a loss of tax revenue that would need to be funded by NZ resident taxpayers. In addition, reducing the corporate tax rate has the distortionary effect of incentivising taxpayers to shelter personal income in companies.

#### PERSONAL TAX RATES

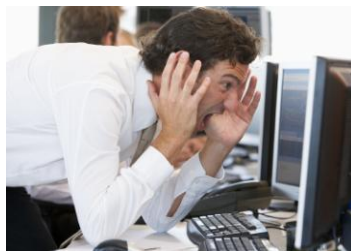
Amongst the various reforms discussed in the report, the one that seems to be most favoured to boost economic welfare is further cuts in personal income tax rates. Personal tax cuts are believed to boost GDP and

increase national savings. A change to the rate would also be easy to implement.

The proposed reforms would no doubt come at a cost. The report recommends that given the current economic environment we are in, any reforms in this area should be presented in a 'package' similar to the 2010 Budget. Further work is required to confirm the consequences of the reforms before changes are recommended for implementation. Hence it is unlikely that any changes will be implemented in the near future. Nonetheless, the report provides a sense of what potential changes could be made in the future.

## DAMAGE TO REPUTATION

Two employment law cases received considerable media attention recently and highlight how employment dispute stories have become very newsworthy. Both involved employers who dismissed employees for reasons either wholly or partly attributable to reputational damage. This should serve as a reminder to other employers to be concerned about the potential implications of this sort of publicity.



The cases were *Hoff v The Wood Lifecare (2007) Limited (2013)* and *Hallwright v Forsyth Barr Limited (2013)* which were heard recently in Christchurch and Auckland, respectively.

In the first case, Hoff, who was a senior caregiver at a retirement village, entered the room of a recently deceased resident on the basis that she wanted to give the village gardener access to water the deceased resident's plants. At that time, relatives of a prospective resident were being shown around the village by the receptionist and went to view the room. Finding the door unlocked, they entered the room and noticed someone, later identified as Hoff, hiding behind the bathroom door. Adding to the suspicious circumstances at the time was that the gardener's glasses were found on the bed next to Hoff's keys. Questions were raised by the employer with Hoff about why she felt she needed to hide behind the door if she was only giving the gardener access to the room. Not satisfied with Hoff's explanation, the employer decided to terminate Hoff's employment, but in doing so the employer rushed the disciplinary process and the correct procedure was not followed.

Following Hoff's dismissal other staff at the village came forward and provided other examples to the employer that Hoff and the gardener had been involved in some inappropriate behaviour.

In response to her dismissal, Hoff challenged her employer and the matter was eventually heard at the Employment Relations Authority. In the employer's favour, their House Rules document made reference to the potential for reputational damage to be considered serious misconduct. The Authority agreed that Hoff's behaviour could have damaged her employer's reputation. However, the employer had followed a flawed disciplinary procedure and compensation was awarded in favour of Hoff, but it was reduced because of her behaviour.

The second case received considerably more media attention when Hallwright, a Senior Investment Analyst, got into a confrontation with another motorist during busy Auckland traffic. Hallwright attempted to diffuse the situation by leaving the scene, but unfortunately drove over the other motorist's leg. Initially Hallwright was given name suppression but the suppression order was eventually lifted and Hallwright was convicted at trial of causing grievous bodily harm with reckless disregard. The employer had carefully allowed the external justice process to take its course before taking its own steps. Hallwright's employment agreement also contained a clause to the effect that damage to the employer's reputation constituted serious misconduct and the employer ended Hallwright's employment.

While it may not be possible to keep events out of the public arena, these cases highlight the importance of employers having robust employment documentation that identifies damage, or potential for damage, to an employer's reputation as serious misconduct. An employer is able to rely on the law to protect them under these circumstances provided they make reference to this in their Employment Agreement and Business Rules. However, as the Hoff case illustrates the employer must also follow a robust process when investigating incidents such as serious misconduct.

## TAX MINIMISATION – HOW DO THEY DO IT?

Multi-nationals such as Starbucks, Apple and Amazon have been under the spotlight lately due to the low amount of tax they pay in comparison to their total

earnings. For example, Google reported that it paid US\$248 million in taxes on foreign income of US\$7.633 billion. However, it is difficult to discern from

mainstream media reports exactly what the issue is. An explanation and example are provided below.

When doing business in more than one country, by necessity or choice, assets and services need to be made available in different countries. This provides the option of arranging that use in an advantageous manner. Take for example, Crispy Fried Turkey (CFT), a hypothetical fast food chain that operates across the US, UK, Australia and New Zealand. Its spread of taxable income and tax payable is detailed in Table 1.

After a visit from its advisor, CFT decides to sell its intellectual property (i.e. its secret recipe) to a new company it incorporates in the Cayman Islands. For use of the recipe, each company in the various countries makes a royalty payment to the Cayman Islands company. The royalty payments are tax deductible in the countries of origin. However, the Cayman Islands corporate income tax rate is 0%. This produces the result detailed in Table 2.

This example is a simple illustration of one of the ways tax can be reduced with some restructuring. In this case the corporate tax rate in another country was used to reduce CFT's total tax payable. Another option would have been to set up a corporate head office, complete with back office support staff and financial

services in a low tax rate country and charge the wider global group for use of those services.

The results achieved in this example are not far from reality. A report by the US Congressional Research Service states that in 2008 American multi-national companies reported 43% of their overseas income through tax havens like Bermuda, Ireland, Luxembourg, the Netherlands and Switzerland, while only 4% of their foreign workforce and investments were in these countries.

The current regime dates back to a time when cross border business was not as common. While technology and globalisation have grown exponentially over the last decade or so, the tax regime has not adapted. The tax revenue forgone by governments is prompting a re-think as to what is appropriate.

Table 1	USA	UK	NZ	AUS	Total
NP before tax	150,000	100,000	30,000	80,000	360,000
Tax rate	35%	24%	28%	30%	
Tax to pay	52,500	24,000	8,400	24,000	108,900

Table 2	USA	UK	NZ	AUS	Cayman	Total
NP before tax & royalty	150,000	100,000	30,000	80,000	N/A	360,000
Royalty Inc / (payment)	(100,000)	(80,000)	(15,000)	(50,000)	245,000	0
Net profit before tax	50,000	20,000	15,000	30,000	245,000	360,000
Tax rate	35%	24%	28%	30%	0%	
Tax to pay	17,500	4,800	4,200	9,000	0	35,500

## REVISION OF TRUST LAW

The Trustees Act 1956 ('The Act') forms the basis of New Zealand's trust law. Given the age of the Act, it can be difficult to interpret and apply in today's environment, which has arguably led to an increase in the number of court disputes.



The Law Commission has been asked to review the Act and trust law in general. The Law Commission has released six issues papers exploring the background and context of trusts in New Zealand. The sixth paper makes a large number of recommendations to New Zealand's trust regime in order to make it fit for a New Zealand context, while being consistent with overseas trust law. Specifically, new legislation governing trusts has been recommended to make trust law clear, coherent and practical allowing it to be understood by the range of individuals who interact with trusts, not just lawyers. Other key changes are outlined below.

### ENHANCED ACCOUNTABILITY OF TRUSTEES

The minimum obligation of a trustee, in order to give a trust substance, is the need to act honestly and in good faith for the benefit of a beneficiary. However, this core duty and other duties identified by the Courts, as established by centuries of trust law, are not encapsulated in the Act. In fact, it is possible to exempt

a trustee from certain duties via the terms of the trust deed, thereby avoiding liability to beneficiaries. It is proposed that the common law duties of a trustee and any exemptions from liability are clearly stated in legislation to clarify a trustee's obligations. It is also proposed that beneficiaries will have the ability to apply to the court to have trustee decisions reviewed.

A common mechanism used to reduce or eliminate trustee liability is the use of a company as a trustee; this is commonly referred to as a corporate trustee. The Law Commission recommends trustee liability is extended to directors of corporate trustees. In addition, the fact that a third party is dealing with a trust and not a company should be disclosed in all communications and contracts. This disclosure will provide creditors with the knowledge that recourse could be limited to a company or its director for the trust's debts.

### TRUST ADMINISTRATION

The process of appointing and removing trustees is determined by the trust deed. There are situations, however, which may not be catered for (e.g. the death of a trustee). In this situation, the appointment of a replacement trustee must be made by the court. A practical resolution for appointing and removing



trustees is proposed where this power is stated in the new legislation, rather than individual deeds. The legislation would cater for:

- clarity around accepting or rejecting a trustee position,
- who can be appointed as a trustee,
- giving a wider range of circumstances where a trustee can be removed (e.g. ineffective or absent trustees, sickness and death),
- giving trustees greater ability to resign, including when they are the sole trustee,
- who may remove a trustee and appoint a replacement, and
- how many trustees a trust should have.

**REVOKING A TRUST**

A notable recommendation is that the common law rule, which allows adult beneficiaries who are in

agreement to revoke a trust, should be codified in legislation. This will also allow new powers to be conferred on trustees or a trust to be modified.

**TRUST REGISTER**

Unlike with companies there is no register of trusts. This makes it difficult for the Government to track, monitor and oversee how trusts are being used and whether or not that use is appropriate. The Law Commission, however, considered that establishing a trust register was unnecessary.

On balance the Law Commission's recommendations are positive. The changes will bring the legislation up to date and resolve some deficiencies in the current law. Whether the final form of the changes results in an increase or decrease in the use of trusts will be interesting to see.

**SNIPPETS**

**FBT ON CARPARKS**

One would be forgiven for thinking that the Government's recent back down on charging FBT on carparks located in the Auckland and Wellington CBDs means that the status quo remains. However, the draft legislation as it was introduced actually includes four proposed changes that would see FBT apply when:



- Carparks are provided in the Auckland and Wellington CBDs (to be withdrawn),
- Carparks are acquired by an employer from a commercial carpark operator for more than \$210 per month,
- An employee specifically chooses to have their salary reduced to receive a carpark, and
- Carparks are provided to an employee on the employer's premises.

As we know, the Government has announced that the first item will not proceed, however they have made no mention of the remaining changes.

Given the detrimental effect to the Government of having to back down on the CBD element it may not have the appetite to push through all of the remaining changes. The only exception might be the salary sacrifice element, as this is part of a broader initiative by the Government to specifically tax salary sacrifice arrangements.

For some employers, the introduction of FBT on parking benefits may mean that it is no longer viable for businesses to provide this benefit as part of an employee's salary package.

**WORLD CLASS APRIL FOOL'S DAY PRANKS**

Businesses around the globe took April Fool's Day in their stride this year, releasing both bizarre and cunning product announcements to consumers. Making our top three pranks are:



- BMW announced the launch of a limited edition BMW P.R.A.M. (Postnatal Royal Auto Mobile). A baby's pram designed using BMW's latest EfficientDynamics technology, with two or four-wheel-drive providing a smooth ride for your child. For those who are "too posh to push", the new P.R.A.M even comes fitted with N.A.P.P.I.E. (Nanny-Assisting Petrol-Powered Injection Engine).
- Virgin Atlantic Airlines announced the introduction of their world-first glass bottomed plane. Scheduled on the domestic service to Scotland, Virgin believes its passengers will appreciate the beauty of the British landscape with this clever new development.
- Finally, a new product called CASH\$IMPLE, to make online banking easier. For those of you with a lot of cash just lying around, the new tool lets you take a picture of your cash, and then instantly deposits it into your account. Simple.



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