



NEWSLETTER

Issue 2
May 2014 – July 2014

INSIDE THIS EDITION

- GST on/off food.....1**
- Managing working capital.....2**
- Home is where the heart is2**
- Working with difficult people3**
- Snippets.....4**
- IT system revamp for the IRD.....4*
- Billions raised through UK tax cut.....4*

GST on/off food

The question of whether GST should be removed from food has been raised in the media and by political parties a number of times over recent years. The objective being to improve the diet and well-being of lower socio-economic groups within society. The idea seems reasonable and is likely to resonate with the “reasonable” person on the street, if only from a perspective of fairness and equity. But would it work? A recent Treasury report has shed some light on the issue and some key messages from the report have been outlined below.



The report provides that the proportion of a family’s food budget does not increase at the same rate as incomes rise. Therefore, an equity argument exists for the rate of GST on food to be reduced. However, given that high income earners spend more on food in an absolute sense, they would actually benefit more from a blanket food exemption.

In addition, to ensure the tax generated from GST remains the same, the GST rate on other items would need to increase by an estimated 2%. This evidences a further flaw in trying to achieve social aims by manipulating GST. The rate can’t flex based on a person’s individual circumstances, the same way that income tax rates do. The rate applies to goods (and services) irrespective of the person buying them.

It is suggested that leaving GST on food and instead redistributing the tax generated from it would have a more progressive outcome than simply removing it all together.

All information in this newsletter is to the best of the authors' knowledge true and accurate. No liability is assumed by the authors, or publishers, for any losses suffered by any person relying directly or indirectly upon this newsletter. It is recommended that clients should consult a senior representative of the firm before acting upon this information.

No consideration is given to a more targeted reduction in GST, such as in Australia where certain types of food are not subject to GST, such as bread, flour, sugar and milk. While other items such as biscuits, cakes and takeaways are subject to GST. Research led by the University of Auckland found that taking GST off fruit and vegetables led shoppers to buy about half a kilogram more fruit and vegetables, per household, each week.

One argument for keeping the status quo is that New Zealand's system is simple and efficient. The

broad based approach avoids the complexity and compliance costs that arguably exist under other regimes; such as Australia's.

The pressure on the New Zealand Government to introduce an exemption on food will only increase if GST increases. However, it is important to ensure any decision is based on rational debate and certainty that it will have the desired outcome, thereby outweighing any associated costs.

Managing working capital

Irrespective of the stage of a business's life cycle, managing working capital is extremely important. During the growth phase, many businesses have failed due to growing too rapidly, and not having the corresponding cashflow to keep up with the expanding needs of the business. Meanwhile, mature businesses need to maintain sufficient working capital to ensure funds exist to meet liabilities as they fall due and to take advantages of business opportunities as and when they arise.

There are two fundamental questions an organisation should ask itself when managing working capital. The first is how much working capital is required and the second is how should it be funded?

A good indication of the working capital requirements of a business can be determined by the 'cash conversion cycle'. This is the length of time from the purchase of inventory or materials to the receipt of cash from customer sales. The length of this cycle can be influenced through the management of debtors and creditors.

Other financial measures that can be used to monitor working capital requirements include debtor days, debtor turnover, inventory days, inventory turnover, creditor days and working capital days. Monitoring these types of ratios over time can help identify problems before they manifest themselves in other more damaging ways, thereby enabling pre-emptive action to be taken.

Tangible 'best practices' that can be adopted to manage accounts receivable, i.e. cash inflows,

include establishing a credit policy, making invoicing clear to facilitate payment, invoicing earlier, reducing payment terms, following up on overdue accounts, offering early settlement discounts and stopping credit to debtors that don't pay. Such practices need to be balanced against their potentially negative impact, such as customers going elsewhere because of unfavourable credit terms.

Conversely, managing cash outflows is also important by taking advantage of early payment discounts, prioritising suppliers, only making payments when they are due, ensuring invoices are checked for accuracy before payment, negotiating

extended credit terms or putting procurement practices in place that are price driven, not relationship driven. However, care needs to be taken to ensure continuity of supply of materials and inventory.

Finally, inventory management is an important aspect of working capital. Techniques can be utilised in order to determine the optimal level of inventory a business

should hold, and the ideal re-order point. A common model that is used is the 'Economic Order Quantity' model which determines the optimal amount of inventory a company should order by balancing ordering costs and carrying costs. Other considerations also include calculating the optimal re-order point so as not to run out of stock, and the consideration of holding 'safety stock' to avoid shortages.

Whether your business is starting up or well established, managing working capital is integral to success.



Home is where the heart is

If an individual is a New Zealand (NZ) tax resident they will be taxed on their worldwide income. Conversely, if a person is non-resident they will only be taxed on their NZ sourced income. This makes it

important for a person to confirm their tax residency when they leave the country as it determines the extent of their continuing NZ tax liability.

A person is a NZ tax resident if they are either in NZ for more than 183 days in a 12 month period or if they have a 'permanent place of abode' in NZ. A person will be non-resident once they are absent from NZ for more than 325 days in a 12 month period and they do not have a permanent place of abode in NZ.



The concept of a permanent place of abode is not defined under the legislation. But the courts have considered the issue on a number of occasions. One recent case has arguably shifted 'the line'.

The Taxation Review Authority recently considered whether a taxpayer was a NZ tax resident over the four year period to 31 March 2007. The taxpayer had worked for the NZ Army for 25 years. After he retired in 2003 he left NZ to work in Papua New Guinea on a 12 month contract providing personal security.

The taxpayer gave evidence that when he left NZ in 2003 he had no intention of returning to live here. After the contract finished in Papua New Guinea, he spent approximately four months living in Queensland, before he began working in Iraq. In Iraq he also provided security services, completing a number of contracts up until April 2012, when he moved back to Australia.

Despite such a lengthy absence, the individual was found to be a NZ resident (and liable for tax on his worldwide income) because he was deemed to have a permanent place of abode here. The following factors were relevant to the decision:

- The taxpayer separated from his wife in 1994 and they had four children together. The taxpayer maintained close family and financial ties to his ex-wife and his children, and he provided financial assistance to them.

Working with difficult people

A 'difficult person' might oppose ideas, be irritating, appear negative or simply not like other people. When it comes to communicating and working with a person who is particularly difficult, we often resort to one of three assumptions:

- the person is ignorant
- the person is stupid
- the person is evil and simply trying to be infuriating

But typically, no one wakes up in the morning thinking 'I really want to irritate everyone I meet

- Although absent from NZ for the majority of the time, between July 2004 and March 2007 (covering the period in dispute), he visited NZ every five to six months, with an average time in NZ of 42 days per year.
- The taxpayer owned rental properties in NZ with his ex-wife (personally and then through a company) that would have been available to him if he served the required notice under the Residential Tenancies Act 1986. Those properties were in the same locality as his ex-wife and children.
- The taxpayer's ex-wife had a debit card to access his US based bank account, to pay property and family related expenses.

Looking at the overall circumstances, the TRA found that the taxpayer continued to have a strong and enduring relationship with NZ, deeming him to be a NZ resident during the four years in dispute. The taxpayer was also deemed to have taken an "unacceptable tax position", which is subject to a shortfall penalty based on 20% of the tax shortfall.

The IRD has also recently issued an Interpretation Statement (IS 14/01) that came into effect on 1 April 2014, that sets out its view on how to determine whether a person is a NZ tax resident. The effect of the TRA decision has been taken into account in preparing the Interpretation Statement, namely the permanent place of abode test requires that a dwelling is available that can be used by the person in NZ. This does not necessarily mean ownership or control over a dwelling. If a person is able to use a property as a place to live on an enduring basis, then it can still be their permanent place of abode irrespective of whether the property is rented to someone else while the person is residing overseas.

Whether someone has a permanent place of abode is not easily determined. It takes judgement to weigh the particular facts and independent professional advice should be obtained.

today' and goes about their day with this goal in mind. The reality is difficult people are often not being difficult on purpose.

A key driving factor behind relationship breakdowns is perception; one party either has a different view of the situation or wants something different. Therefore, when a person is being 'difficult' the first thing to try and do is to look at the situation from their perspective. If you can get your head around how the other person views the situation, this will help guide your approach when communicating with the person.

It is also important to be strategic. Although people cannot be controlled, they can be influenced so it is essential that you keep in mind what it is that you want to achieve. The following six tactics are recommended to help manage a difficult person:



- start with what you agree on
- consider what you can learn; what might you be missing?
- outline what you want from the conversation
- stick to topic
- wait to respond
- silence is golden; do not just talk to fill space

Actively trying to manage challenging people, taking into account their views and position, can help alleviate or prevent moments of tension and

misunderstanding. With a bit of work, difficult people can become more bearable and the outcome for you can be improved.

Conflict can often trigger defensive emotions but it is important to react in a manner that does not separate you from the situation. Self-management techniques such as focusing on breathing, listening attentively, preparing for bad and unexpected outcomes, and stepping back to adopt a long-term view can help you react in a constructive way.

People who irritate us can often show us something about ourselves. Taking the time to consider our own behaviour in strained situations may reveal personal deficits that contributed to the difficulties. Delving into the root cause of the frustration can help to resolve the problem. In fact, you yourself may be the difficult one.

Snippets

IT system revamp for the IRD

The IRD's current IT system was developed back in the 1990s, before Microsoft Windows and smart phones. Over time the system has been modified to cater for various Government initiatives such as student loans and working for families. It is generally accepted that the system is now unable to readily cope with further change.

An overhaul of the system is planned and is expected to cost \$1.5b over a 10 year period. Arguably the upgrade is well overdue with recently released IRD papers revealing that half of the IRD's data entry staff spend their time correcting data entries in the system.

The upgrade appears to be in motion with a recent speech by the Minister of Revenue setting out the IRD's approach to the transformation. Of interest is that the overhaul may involve more than just the IT system. The Minister has indicated that NZ's tax administration process is also in need of change by introducing new processes to meet the changing needs of businesses and individuals.

A sign of the changing times can be seen in the form of a recent competition where the IRD asked for input in the design of an IRD App. The competition aimed to develop an App that makes interactions with the IRD easier, improves information sharing and allows for greater self-management by taxpayers.

Hopefully a more efficient, modern system for both the IRD and its customers is on the horizon and we don't end up with Novopay v2.

Billions raised through UK tax cut

New Zealand's top personal marginal tax rate is 33% and no doubt whether it should be increased or decreased will be debated as we go into this year's election. But recent experience in the UK suggests that a tax cut could provide the Government with more tax revenue. Sounds strange doesn't it...

The UK's top rate was increased to 50% by the Labour Government in 2010. Then last April, the Coalition Government cut the rate back to 45%. This drop is said to have significantly increased the amount of money the wealthy are paying to the UK Government.



Figures released by HM Revenue and Customs shows that there has been a £9 billion increase in tax receipts this year following the reduction from 50% to 45%.

There have been mixed views as to the exact reasons for the increase in tax revenue. Some consider it proof of encouraged investment into the UK following the tax cut. Others are of the view that high-wealth individuals delayed returning their income in 2012-13 knowing a change in rate was coming, leading to a big increase in 2013-14.

Several politicians are now pushing for the top tax rate to be cut to 40%.

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