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INSIDE THIS EDITION

Take a break 1

Deductibility of Healthy Homes costs 2

Purchase price allocations 3

What is revenue? 3

Snippets 4

Accounting for COVID-19 4

FBT on vehicles during lockdown 4

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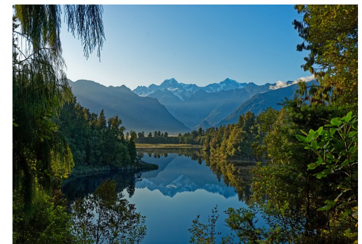
Take a break

In the months since the peak of COVID-19, the stringent restrictions have been relaxed and the majority of us have returned to a 'new normal'.



What this looks like from business to business is likely to be quite different, with some returning to the office full-time and others continuing to work remotely. Whichever the case, the disruption of COVID-19 is sure to have impacted employee morale one way or another.

It is not uncommon for morale to take a dive as the mid-year lull takes effect. Typically, a dip in motivation might be offset by an escape to the islands or trip across the world. But with the ongoing restrictions on international travel, escaping the New Zealand winter is proving harder than ever. So, how can employers boost morale in a time where uncertainty prevails?

For many, COVID-19 fast-tracked a move toward more flexible ways of working. Now, experts suggest that ongoing flexibility is key to keeping employees motivated and engaged. Key the introduction of the "hybrid work model", which allows employees to split their time between working from home and the workplace.

A recent Salesforce survey revealed that the appeal of a hybrid model particularly appealed to Gen Z with 43% indicating a preference to split their time between the office and home. Thirty-three percent of millennials agreed, however, baby boomers showed the least desire with only 26% preferring the new approach.

A hybrid model is most likely to benefit those who experienced increased, or at the least maintained, productivity throughout the lockdown period, while

also recognising the value of face-to-face interaction and collaboration with colleagues.

It is no surprise that working from home on a permanent basis may eventually lead to employees feeling isolated and disconnected, with motivation suffering as a result. However, splitting time between home and the office allows employees to capitalise on increased flexibility, while also maintaining social contact.

Beyond flexibility, we can all no doubt recognise the benefit of taking time off. Although travel restrictions may see less people rushing to get in their leave applications, management should still encourage employees to take annual leave.

The push to get our local tourism industry back up and running has been well publicised and with the borders set to remain closed for the foreseeable future, New Zealanders getting out and exploring the country will be vital to the recovery.

Whether it be a few extra long weekends, or an extended trip elsewhere, both will help employees avoid burnout and emerge from the post pandemic world motivated and more engaged.

With varying degrees of optimism for when, or if, a pre COVID world will return, the small 'wins' and any look of normalcy will go a long way in boosting morale.

Deductibility of Healthy Homes costs

If you are an owner of a residential property, you will be familiar with the Healthy Homes Standards that were introduced on 1 July 2019.

The standards set out the minimum requirements all landlords are required to comply with. Examples of the mandatory requirements include fixed heaters in the main living room, smoke alarms, ceiling and underfloor insulation and ground moisture barriers for some properties.

For older homes, the costs of bringing a residential rental up to the standard required could be substantial.

Inland Revenue (IRD) recently released QWBA 20/01, which provides guidance on the deductibility of the costs incurred to meet the Healthy Homes Standards. To summarise, the statement broadly classifies such expenditure into three categories:

- revenue expenditure that is immediately deductible,
- capital expenditure that forms part of the building and is therefore unable to be deducted at all because the depreciation rate for residential buildings is 0%, and
- capital expenditure that does not form part of the building and is therefore likely to be depreciable.

The Commissioner has stated that expenditure will be capital if the work results in the reconstruction, replacement or renewal of the whole asset or substantially the whole asset, or goes over and above making good wear and tear and changes the character of the asset beyond a repair.

Conversely, expenditure that does not meet this definition will be revenue in nature and immediately deductible.

The QWBA also provides that the cost to repair items that would otherwise meet the standards if they were in an operational or reasonable condition, are likely costs of a revenue nature and hence immediately deductible.

In the QWBA, IRD commented the following capital items are likely to comprise part of the building and therefore unable to be depreciated due to buildings having a 0% rate:

- smoke alarms
- insulation
- openable windows
- exterior doors
- ducted or multi-unit heat pumps
- most extractor fans or rangehoods
- ground moisture barriers
- drainage systems

The cost of a capital item that does not form part of the building may be either depreciated over time or deducted immediately if it meets the 'low-value asset threshold'. For assets that fall into this narrow category it would be worth making the upgrades between now and 16 March 2021 because the threshold has been temporarily increased to $5,000 and will move to $1,000 from 17 March 2021 onwards.

Examples of such assets provided in the QWBA are:

- electric panel heaters
- single-split heat pumps
- through-window extractor fans and window stays
- door openers and stops

Unfortunately, it appears no tax relief has been introduced for residential rental owners who are required to spend considerable cash on upgrading their properties to comply with the Healthy Homes standards.

IRD's position is reminiscent of their view on leaky home repairs, for which tax disputes are on-going.

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Purchase price allocations

Currently, if you enter into a sale and purchase agreement for the sale of business assets, there is no standard practice for how the price should be allocated to the assets. For example, a single price may be agreed for all assets, or the agreed price might be allocated on a line by line basis to each asset.

If the purchase price is not allocated with sufficient detail, inconsistent outcomes can arise when each party takes a tax position.

Take, for example, a business comprised of land and depreciable property that is being sold for $800k. The vendor's fixed asset register includes depreciable property that originally cost $400k that has been depreciated down to $150k, and land that originally cost $350k.

The vendor takes the view that the depreciable property was sold for $100k and claims a $50k loss on disposal. The $350k gain on the sale of the land is treated as a non-taxable capital gain.

Conversely, the purchaser treats the depreciable property as purchased for $250k (thereby providing a future depreciable cost base of $250k), allocating the remaining $550k purchase price to the land.

The mismatch between the consideration adopted by the vendor and purchaser in relation to the depreciation property will mean their total tax deduction is overstated by $150k. The difference in value is funded by the Government – it is 'out of pocket'.

To avoid this outcome, draft legislation was introduced in June 2020 that prescribes how assets are to be treated on sale. The proposed legislation provides an ordered approach:

1. If the parties agree a purchase price allocation, they must both follow it in their tax returns.
2. If the parties do not agree an allocation, the vendor is entitled to determine it, and must notify both the purchaser and IRD of the allocation within two months of settlement date. However, the allocation to taxable property cannot result in additional losses on the sale of that property.
3. If the vendor does not make an allocation within the two-month timeframe, the purchaser is entitled to determine the allocation, and notify the vendor and IRD.
4. If no allocation is made by either party, the vendor is treated as selling for market value, but there is a risk the purchaser is deemed to acquire property for nil.

A de-minimis has also been proposed – if the parties do not agree an allocation, the rules will not apply to a transaction if the total purchase price is less than $1 million, or the purchaser's total allocation to taxable property is less than $100,000.

Irrespective of the agreed values, IRD may still challenge them if they consider they do not reflect market value. The rules will apply to sale and purchase agreements entered into from 1 April 2021.

What is revenue?

"Revenue means the total amount of money a business has earned from its normal business activities, before expenses are deducted" (Work & Income, July 2020).

This core definition has been applied by thousands of businesses to apply for the Government's wage subsidy scheme that was implemented due to the COVID-19 pandemic. Whether a 30 percent or more reduction in revenue for the original wage subsidy, or a 40 percent or more reduction for the wage subsidy extension, quantifying the reduction in 'revenue' was a key hurdle to be eligible.

With the potential for wage subsidy applicants to be audited, documenting the basis for an application and how the eligibility criteria have been met is critical. In some cases, confirming eligibility should be straightforward. Retail stores, restaurants, cafes and bars that had to shut their doors overnight should be able to demonstrate a clear drop in 'revenue'.

However, for other industries it may not be as straightforward. In some cases, the time at which an invoice is issued for GST purposes is different to the point in time at which income is recognised for tax and / or accounting purposes.

Take for example the construction industry where jobs are invoiced based on specific milestones. If invoices were raised during the lockdown, for work completed prior to the lockdown, then measuring the

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change in revenue based on 'invoicing' would not provide a fair reflection of the effect of Covid-19 at that point in time.

It goes both ways - if a professional services firm was able to keep working during the lockdown but stopped issuing invoices for a particular period. The firm's invoicing in that period would not provide an accurate reflection of the change in 'revenue'.

The Work & Income definition also refers to "money". Was this intended to have the same meaning as 'income' or is it intended to imply a cashflow test?

The different ways the revenue test is able to be interpreted, and not knowing what the audit process will comprise gives rise to uncertainty. A suggestion is to ensure that the method used to calculate the revenue reduction should be logical within the context of a particular business. If a standard measure, such as sales booked in the period does not align with what has occurred in practice, consider whether that is an accurate method.

Consideration should also be given to sensor checking eligibility using different approaches to ensure the outcome feels right. For example, a service-oriented business could look at hours worked by the team and cross check that against movement in WIP and sales.

If multiple measures have been used, and each supports the reduction in 'revenue' required to receive the wage subsidy then this suggests a reasonable approach has been taken.

Snippets

Accounting for COVID-19

As a means to instil stakeholder confidence, some companies have implemented 'alternative' accounting methods to adjust their financial results for the impact of COVID-19.

Adjustments seen so far include excluding "coronavirus-related expenses". For example, payments of financial assistance to staff impacted by COVID-19 and the costs of personal protective equipment, thereby supporting a higher net earnings amount.

When one company posted its first-quarter results it excluded the effect of Covid-19 (incremental bad debt expenses, production shutdown costs, and payments to front-line workers) from its adjusted earnings per share on the basis that the costs were expected to be "short term".

Some might call this wishful thinking as such adjustments imply the pandemic is a short-lived one-off event. However, globally, the crisis is very much still ongoing, with the potential to impact future revenue and expenses more significantly than it already has.

At the other end of the scale, investors should also be aware of companies over-reporting expenses in the pandemic-affected periods (whether Covid-19 related or not) to create a false sense of rapid recovery once the crisis is over.

Whether the adjustments are to improve the quality of information available to investors or because executive remuneration is linked to margin-based key performance indicators, you be the judge...

FBT on vehicles during lockdown

You wouldn't be blamed for assuming Fringe Benefit Tax (FBT) wouldn't apply to motor vehicles during the Level 4 lockdown period. Other than essential workers, most employees were either working from home or simply unable to work at all and therefore most vehicles were 'parked-up'.

However, a fundamental premise of how FBT applies to vehicles is that it is focused on "availability" rather than actual use. As such, Inland Revenue has confirmed that if an employee had the right to use a motor vehicle for private purposes, then this will attract an FBT liability as normal – regardless of whether the employee actually used the vehicle.

With the benefit of hindsight, employers who took the pro-active step of engaging with their employees to agree restrictions regarding the use of company vehicles during the lockdown period could have reduced their FBT cost. However, understandably, FBT was not at the forefront of businesses' minds as attention was on likely focussed on more important issues such as cashflow and customer relationships.

Let us hope there is not another lockdown, but this could be something to think about if there is.

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

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