FARM ACCOUNTING NZ

BUSING RUSSELL

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Minimum Wage Update

From 1 April 2017, the minimum wage increased to $15.75 per hour, up from the previous rate of $15.25. With the employer's KiwiSaver contribution added, this takes the minimum wage rate up to $16.22 per hour. If the employee is on a casual basis, holiday pay of 8% needs to be added, taking the minimum wage up to $17.01 or $17.52 including KiwiSaver.

All employees must be paid at least the minimum wage for every hour they work. This applies to both salaried and waged employees.

The longest period that an employee's remuneration can be averaged over is a fortnight, meaning that employees must receive at least the minimum wage for every hour they work within a fortnight. The practise of averaging an employee's earnings over the season, with employees working long hours over spring and less hours over autumn and early winter, is now prohibited.

Accommodation and Minimum Wage

Accommodation can be included in an employee's remuneration for the purposes of calculating the minimum wage. It forms part of the employee's gross salary and is therefore included in the minimum wage. The accommodation should be at market value.

See The Back Paddock article in **FARM ACCOUNTING NZ** Volume 104-105 for further discussion on this.

Non-Cash Benefits

Non-cash benefits, such as firewood, food, wet weather gear, etc., cannot be included in an employee's remuneration for the purposes of calculating the minimum wage. However, if the benefits are paid as cash (cash-benefits) and then deducted after PAYE, they can be included in the remuneration for the purposes of calculating the minimum wage.

Employee cash allowances for items such as travel, wet weather gear, motorbikes or dogs are excluded from the minimum wage calculation, as these are a reimbursement rather than a cash benefit.

Type of Minimum Wage

		Hours per Week		
	Per Hour	*40*	*50*	*60*
Adult	$15.75	630	788	945
Starting Out	$12.60	504	630	756
Training	$12.60	504	630	756

Annualised Minimum Wage

		Hours per Week		
	Per Hour	*40*	*50*	*60*
Adult	$15.75	32,760	40,950	49,140
Starting Out	$12.60	26,208	32,760	39,312
Training	$12.60	26,208	32,760	39,312

Paying Employees Under 16

There is no minimum wage for employees under 16, but all the other minimum standards, employment rights and obligations apply. When an employee turns 16, they must be paid the relevant minimum wage (even if they were paid less than the minimum wage when they were 15).

In this issue ...

For farmers who are paying their children on the farm, the rate of pay needs to reflect the child's wage and the work that they are undertaking. PAYE must be deducted from all children's wages.

Section GB 23 of the Income Tax Act 2007 prohibits the payment of excessive remuneration to relatives. The level of remuneration will be specific to the client and the child, but should be considered against the market rate and current minimum wage.

CORRECTION – Deductibility of Food and Drinks as Gifts

Volume 104-105 of **FARM ACCOUNTING NZ** contained an error in that it stated gifts of food and alcohol that were not provided or consumed at a venue were 100% tax deductible.

The Inland Revenue's Agents Answers Issue 193 August 2016 noted that the entertainment expenditure rules in subpart DD of the Income Tax Act 2007 <u>limit deductions, to half the deduction</u> that would normally be available for spending on things like chocolates or bottles of wine provided as gifts to customers, clients or suppliers. (emphasis added)

The Inland Revenue's September 2016 Technical Tax Area Operation Position states that:

"In terms of Section DD 1(1), the gifts are of food and drink that will provide a private benefit to the recipient and a business benefit to the taxpayer. It is not a requirement of subpart DD that there be a private benefit to the taxpayer. If provided off a taxpayer's business premises, such gifts will be within Section DD 2(5) and the taxpayer will only be allowed a 50% deduction for expenditure on them."

This has been an area of confusion for a number of years, with some accountants and tax agents treating the expenditure as fully deductible while others claiming only 50%.

The Inland Revenue's position has changed since 2011 and 2012 when the Business Tax Update (BTU) Issue 26 December 2011, stated *"you can generally claim 100% of the costs of gifts, such as food, wine or event tickets, as an expense"*.

In Business Tax Update Issue 27 February 2012, there was an attempt to explain the rules in more detail by noting among other things, that *"a food and wine gift basket is fully deductible as long as it's not provided or consumed as outlined below."* There followed a description of 'entertainment expenditure' for which limited deductions are available. This included *"food and drink provided or consumed...away from the taxpayer's business premises, e.g. a business lunch at a restaurant".*

Inland Revenue will be applying this interpretation for tax positions taken on or after 1 September 2016.

The Inland Revenue will not be looking to identify deductions incorrectly claimed before 1 September 2016 due to the small size of deductions that may have been over-claimed.

However, over-claimed deductions identified in the course of an investigation or audit activity will be disallowed and the correct view of the law applied. Proven reliance on the BTU statement will be relevant to the question of interest on unpaid tax and shortfall penalties.

From a practical standpoint, when deciding on the deductibility of a gift or gift basket, the emphasis will be on whether the gift contains any food or beverages. Gifts that don't contain food or beverages will be fully deductible. If the gift does contain food or beverages, it may be easier to simply claim a 50% deduction rather than doing a fully itemised analysis of the gift basket or hamper's contents.

Duck Shooting

The duck shooting season starts on the first weekend in May, so in April and May, the pest control expenses of many of our farmers starts to increase.

Duck shooting is generally considered a recreational or personal activity. For many, it is one of the sporting and social highlights of the year.

The deductibility of the duck shooting expenses needs to be considered in relation to the individual client. For many shooters, the duck shooting related expenditure will be personal. However, for farmers, the expenditure may be a legitimate pest control expense and therefore deductible.

In New Zealand, all ducks are classified as game birds and can only be shot during a short window of time during May and June (exact season dates differ between regions).

Their hunting is governed by Fish & Game New Zealand and any hunting or shooting of ducks outside this window is a criminal offence. Restrictions are placed on how and where ducks and other game bird species can be hunted, and the quantity that can be shot.

Fish & Game regulations permit a farmer, their spouse, and one son or daughter to hunt game birds on the farmer's land without needing a licence. All other hunters are required to purchase a game bird licence. This exemption is only for the farmer's land, and they are required to purchase a licence if shooting on another person's land.

For farmers with crops or newly sown grass, large numbers of ducks and geese can quickly become a problem. Four paradise ducks can eat as much as one ewe. As they are classified as a game bird species, they cannot be hunted or culled like other pest species such as rabbits or possums. This makes it difficult for farmers to protect their crops and pasture from game birds.

Farmers can apply to Fish & Game New Zealand for a special out-of-season permit, but this is aimed at allowing farmers to use firearms to scare birds off their crops rather than to actively reduce numbers. In some regions, Fish & Game New Zealand allows special hunting weekends in late summer/autumn to reduce bird numbers.

The duck shooting season provides farmers with an opportunity to legally hunt ducks and to reduce their numbers. For some farmers this will be a personal activity, while for others it is a pest control activity. This will depend on the client.

A shotgun will generally cost over $500, so will need to be capitalised. These are also used for pest control purposes, so its business use percentage may be high, especially when you consider that duck shooting opening morning is only one day of the year. Ammunition is purchased in large quantities (cheapest when bought in 250 or 500 round packs), and often stockpiled for pest control over the rest of the year. The same ammunition bought for ducks can be used for managing rabbits, hares, possums and wallabies.

To attract ducks to the shooter's location (camouflaged hides or maimai), decoys and callers are used. Decoys range in price from $10 for static plastic ducks to several hundred dollars for mechanical decoys.

Duck shooting licences can be purchased directly from Fish & Game as well as most hunting stores. A whole season's licence costs around $93, while a day licence costs $21.

Death of a Farmer – Partnerships

This is part two in our 'Death of a Farmer' series. These articles are focusing on the accounting process, business structure, taxation and communicating with surviving family members.

In this article 'Death of a Farmer – Partnerships', we will be assuming that the farming partnership includes both revenue and capital account property including land, buildings and livestock. In these examples, we are looking at a partnership that includes at least one individual person. The typical partnerships we come across are the husband/wife variety, but may also include parents and children or siblings.

Definitions that we need to know:

Tax Base Property (defined in Section FC 1):

a) revenue account property

b) an attributing interest in a foreign investment fund (FIF)

c) a financial arrangement other than an arrangement for which the deceased person, or their Trustee, was a cash basis person

d) an item for which a deduction for an amount of depreciation loss arises

For a farmer, this would include livestock, depreciable property and harvested stock on hand.

Rollover Relief – the transaction is treated as an acquisition at tax written down value, rather than at market value.

Two Degree Relationship – A person within two degrees relationship to the deceased – includes grandparents, parents, siblings, children and grandchildren.

Life Interest – Gives the recipient a free right to occupy, enjoy and receive the income of an asset or fund, for the rest of their life.

The Will

The Will is the key document with the death of a partner. This provides the instructions for distribution of their share of the assets.

The treatment of these assets depends on what instructions the deceased has left. The most common bequeaths are leaving assets to:

- spouse, civil union or de facto partners
- close relatives or Charities
- an Estate
- a Trust

Leaving Assets to Partners

Where the deceased leaves their assets to the surviving partner, Section FC 3 of the Income Tax Act 2007 provides rollover relief from income tax on the initial distribution from the deceased to the executor, and on the second distribution from the executor to the surviving partner. This means there is no tax payable on the difference between the market value of the tax base property and its tax value at either distribution stage.

FC 3(2) holds that the transfer *including any intervening transfer to an executor or administrator, is treated as a transfer of property under a settlement of relationship property under subpart FB (Transfers of relationship property).*

However, the relief available under Section FC 3 does not apply if any tax base property is left to any person outside a two degrees relationship. If tax base property is left to the surviving partner and other close relatives, the relief under Section FC 3 applies to only the surviving partner. For distributions to the close relatives, look at relief under Section FC 4.

If <u>any</u> tax base property is left to any person outside the second degree of relationship, there is no rollover relief available to the surviving partner. Instead, the tax base property would be disposed of at market value at date of death. Bequeaths that would prevent the rollover relief applying would include distributions to extended family (nieces/nephews/cousins), Charities or Trusts.

If the assets are left to a Trust, but with a life interest being left to a surviving partner, the rollover relief will not apply.

Where Section FC 3 does apply, the assets transfer to the surviving partner at their historical cost. The partnership would then be wound up and the surviving partner would carry on in business as a sole trader. This means the new entity (sole trader) needs to be GST registered and the old partnership deregistered for GST.

Leaving Assets to Close Relatives or Charities

When the deceased's Will leaves tax base property to close relatives or Charities, the assets transfer from the deceased to the Estate, and then from the Estate to the close relatives or Charities.

Section FC 4 provides rollover relief for the transfer of tax base property from the Estate to relatives (within two degrees) or to Charitable entities. A tax return is required to be done to date of death, which includes tax base property at market value. For Section FC 4 to apply, the tax base property must be transferred:

- to a close relative or a Charity, and
- no life interests in property are created, and
- no Trust over the property is created (other than to execute the Will and administer the Estate), and
- the net income of the Estate is distributed under the terms of the Will and by the Trustee's legal obligations.

If any tax base property is left to people other than the spouse, civil union or de facto partner, relatives outside two degrees or Charity, the rollover relief does not apply. The transfer from the deceased to the Estate is at market value and the transfer from the Estate to the beneficiaries is also at market value. If there is a time delay in the Estate making the distributions, a new market value may be required.

With Section FC 4, the transfer of tax base property from the deceased to the Estate is at market value at date of death. The Estate uses this value when making distributions to the beneficiaries. This becomes the effective cost base for the assets received by the beneficiaries.

Leaving Assets to Estates or Trusts

When the tax base property has been left to an Estate or a Trust, none of the rollover relief provisions apply and a new partnership is created.

This will require a new IRD number, GST registration (if applicable) and creates a new partnership name.

Accounting for the Transactions

In situations where the rollover relief to the surviving partners (Section FC 3) does not apply, the deceased is required to return the tax base property at market value at date of death. For a farmer, this generally would include profit on the deemed sale of livestock, depreciation recovered on fixed assets, and for dairy farmers, the dairy proceeds from production up to the date of death.

In these cases, the deceased's share of depreciation recovered and livestock income needs to be calculated and returned in the deceased's tax return to date of death. This needs to be recorded in the Notes to the Accounts, as the incoming partner's share of the tax base property will have a different cost base and there needs to be a record of what has already been adjusted for taxation purposes.

On the eventual dissolution of the partnership, the separate cost bases of the different partners need to be considered.

The original surviving partner needs to account for their share of the full depreciation recovered and livestock income.

The new partner needs to account for their share of the depreciation recovered and livestock income less the amount that was returned by the deceased at date of death. This will reduce the new partner's taxable income by the deceased's share of depreciation recovery and livestock profits already returned at date of death.

The exiting partner's income has already been declared, and this is reduced for the remaining partners if no new partner is introduced.

Deductibility of Farm House Expenses

The Inland Revenue's March 2017 Interpretation Statement IS 17/02 'Income Tax – Deductibility of Farmhouse Expenses' alters the deductibility of farm house expenses.

Prior to the release of the interpretation statement, the Commissioner permitted full-time farmers to claim full deductions on dwelling rates and mortgage interest ,and to also claim 25% of farm house expenses.

Under the new rules, the deduction on farm house expenses has reduced from 25% to 20%.

The deductibility of the dwelling's rates and mortgage interest now depends on the value of the farm house relative to the total farm. If the value of the house is less than 20% of the total farm value, 100% of the rates and interest may be claimed. If it is greater than 20%, the farm owner is required to do a use of home office claim. The deductibility of the home telephone rental is now reduced to 50%, unless a higher business use portion can be warranted.

These rules apply from the commencement of the taxpayer's 2017-2018 income year. Previously, the Inland Revenue had generally accepted that a full-time farmer could claim 100% of dwelling interest, rates and telephone rental, and 25% of the farm house expenses.

New Test

With the new interpretation statement, the Commissioner has stepped away from the test of 'full-time farmer', and is now basing the test on the value of the farm house compared to the total value of the farm (including house). This approach has been taken as a way of mitigating the compliance costs for farmers with a low private use element.

Previously, the deductibility of farm house expenses was based on whether the taxpayer was a full-time farmer.

The test for this went back to Grieve v CIR (1984) and involved a twofold test that considered the nature of the activities carried on, and the intention of the taxpayer in engaging in those activities.

The taxpayer's intention was then subject to a seven point test that included statements made by the taxpayer, the nature of the activity, the scale of operation and volume of transactions, taxpayer's commitment, pattern of activities and financial results.

Instead of full-time and part-time farmers, farming taxpayers are now categorised into either Type 1 or Type 2 farms, depending on the relative house to farm values.

Type 1 farms – farming businesses where the value of the farmhouse (including curtilage and improvements) is 20% or less of the total value of the farm.

Type 2 farms – farming businesses where the value of the farmhouse (including curtilage and improvements) is more than 20% of the total value of the farm.

Type 1 farmers can continue to claim 100% of the dwelling rates and mortgage interest, while type 2 farmers are required to complete a use of home office claim based on the area and portion of time the dwelling is used for business purposes.

For example, consider a Type 2 farmer who has no dedicated farm office, but uses 30% of the house for business, 20% of the time; using the kitchen, dining room table, lounge and laundry for business purposes at different times. Based on this, they can claim 6% (30% of area x 20% of time) of household expenses, interest and rates as a deductible expense. The remaining 94% of household expenses would be personal. The farm interest and rates will be 100% deductible.

How to Value the House and Farm

The Commissioner will accept a reasonable estimate of valuation for the farm house and farm when applying the Type 1/Type 2 test. This may be done using rateable values, a bank valuation, historical cost, insurance values or a formal valuation.

When considering the value of the farm, the value will include the value of the farm land and all assets attached to it. This would include all buildings, orchards, kiwifruit, vines and shelterbelts. It would exclude stock and crops. The land would include all blocks of land being farmed together, even if they are on different titles or locations.

A rateable valuation is the easiest test to apply, but these valuations do not differentiate the value of the dwelling from other farm improvements such as other farm buildings, vines or fencing. This approach will be suitable where the value of all improvements is less than 20% of the farm value.

Historical cost can be used, although the relative costs of the farm and dwelling need to be *comparable and contemporaneous*. If used, the costs have to be from a similar period, so the values from a farm purchased in 1970 with a dwelling build in 2015 would be unsuitable. However, the costs of a house and farm purchased in 2014 would be acceptable.

In cases where the dwelling to farm ratio is close to 20%, a formal valuation may be required to meet the Type 1 criteria. This test would generally be required to be done only once, unless circumstances change. This might include a Type 1 farmer making extensions to the dwelling or a Type 2 farmer purchasing additional land. We have developed a simple spreadsheet to use for this calculation.

Household Expenses

For dwelling operating expenses such as repairs, electricity and insurance, Inland Revenue will now permit a 20% deduction without needing any supporting evidence. This is permitted for all farming taxpayers, regardless of the size or scale of their operation.

The 20% is the accepted minimal claim and a greater proportion of the expenses can be claimed, if the higher percentage can be warranted. This would be considered on a client specific basis.

When considering whether the deduction should be greater than 20%, the area of the dwelling and time used for business purposes needs to be considered.

Telephone Rental and Fixed Line Charges

Farmers who operate their business from home may claim 50% of their telephone rental charges. If they can show the business use is greater than 50%, then more can be claimed.

Previously the general practise was that 100% of the telephone rental was claimed. Toll calls will continue to be claimed according to whether they are business or personal. In the case of fixed fee calling plans (i.e. free nationwide calls for $20/month), the deductibility will depend on whether the calls are for business or personal use. For those farmers who are required to make a toll call when phoning the nearest town, the calling plan charges will tend towards being deductible.

<table>
<tr><th>Farm Type</th><th>Interest and Rates Charges</th><th>General Farmhouse Expenses</th><th>Fixed Line Telephone Charges</th></tr>
<tr><td>Type 1</td><td>100% deduction for rates and interest expenses relating to the farm, including the farmhouse.</td><td>Dissection where possible, then 20% deduction unless the taxpayer can substantiate a higher deduction.</td><td>50% of telephone rental charges used for both business and private purposes, unless the taxpayer can show that 50% is too low.</td></tr>
<tr><td>Type 2</td><td colspan="2">Dissection where possible, then apportion between farm and farmhouse on a fair and reasonable basis. Deduct amounts attributable to actual business use of the farmhouse.</td><td>50% of telephone rental charges used for both business and private purposes, unless the taxpayer can show that 50% is too low.</td></tr>
</table>

FAQ: Inherited Livestock

Question:

A practitioner recently contacted us to ask how they should deal with some cattle that a client had received as part of the client's father's Will. The client was also a cattle farmer and was GST registered.

The specific questions included:

1. How should they bring them into the books?
2. Could they claim a deduction for the 'cost' of the cattle, and if so, at what cost?
3. Can GST be claimed on the inherited livestock?

Answer:

When considering a situation like this, we need to consider who received the inherited livestock. This is one of those times when we need to know the **entity** concept that is fundamental to accountancy.

The **business** is an **entity** which is separate and distinct from the **owner(s)** of the business.

In this case, the person who received the cattle was an individual who also happened to be the **owner** of a business. The individual then introduced the cattle into the **business entity**.

The journal to introduce the cattle into the business would be:

DR Cattle Purchases

CR Funds Introduced

What we have is a notional 'sale' from the individual owner to the business. This is in much the same way that assets are introduced to a business start-up from the individual to the business.

The transaction should occur at the current market value, so we need to obtain an appropriate current market value to complete the journal entry to bring the inherited cattle into the books.

Where the farming entity is a company, a cash payment is required to bring the livestock into the business. This can be done using a cheque swap or a transfer of funds between the company and the individual (the individual advances the company the funds to pay the individual for the livestock).

GST

It is not possible to claim a GST input tax deduction on the cost of the cattle. This is because **livestock** is specifically excluded from the definition of secondhand goods in Section 2(1) of the GST Act. There will, however, be GST to be returned on the eventual sale of the cattle.

Tax Treatment of Livestock Owned Prior to Going into Business

A similar tax treatment applies to livestock owned by individuals before going into business as farmers. The livestock may have been owned as a hobby or lifestyle block. On going into business, the livestock are introduced at their current market value and with no GST input claim.

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Editor's Note

We welcome brief questions and comments or suggestions from subscribers and readers. If you have a problem, we might have an answer and everyone might like to know about it.

THE BACK PADDOCK

ACC CoverPlus Extra

ACC CoverPlus Extra has been available for the self-employed since 2001 and we have been keen advocates of CoverPlus Extra, especially for farmers.

ACC CoverPlus Extra allows farmers to choose their level of cover, provide certainty of income, and all at a reasonable cost.

ACC CoverPlus Extra provides a key benefit with the agreed level of cover. The amount of cover is negotiated at the time of application for cover, and at claim time, there is no requirement to prove loss of earnings. Generally, if the farmer is required to make an ACC claim, they are probably not in the best physical or mental state to be filling out paperwork.

ACC CoverPlus Extra has provided a useful service over the last five years as dairy farming incomes have fluctuated with the dairy payout. From a $7.90 payout in 2008 to $8.40 in 2014, all the way down to $3.90 in 2016.

Regardless of their earnings, our clients have had an agreed level of cover. They have had certainty, and have not been over insured in the high income years or left with insufficient cover in the low income years.

When working with our clients on choosing an appropriate level of ACC cover, the key question that we keep coming back to is what will they need in the event of an accident?

CoverPlus Extra allows the cover to be set at a level to provide for the replacement labour, rather than have to fund it from a poor cash flow. How much will the replacement labour unit cost? Wage costs seem to increase annually, and to get a decent employee to run the farm in the farmer's absence will cost more than minimum wage.

If the husband is seriously injured and in hospital, his wife will be at the hospital with him. She will be away from the farm, unable to supervise the replacement worker. What the farm needs is someone who can run it unsupervised. Minimum ACC cost equals minimum ACC cover. This isn't always the best answer.

When looking at the appropriate level of ACC cover, we also need to consider whether they are taking private insurances and the client's cash flow. For first year farmers, the cash flow may be tight, but what ACC and insurance cover do they need?

The CoverPlus Extra levy is payable at policy acceptance, where CoverPlus is payable in arrears.

ACC provides loss of income cover for accidents, but does not include loss of income due to illness.

As clients get older, the risk of time away from work due to illness or health problems such as cancer, strokes or heart attacks, increases.

Other clients may be unable to get private insurance due to pre-existing medical conditions, so taking ACC CoverPlus Extra provides a means of gaining some insurance cover. However, some pre-existing conditions may not be covered.

At present, the minimum level of ACC CoverPlus Extra available is $24,544 per annum before tax ($590 per week before tax). The maximum level of weekly compensation available is $97,650 or $2,309.04 per week. These amounts are for the 2016/2017 levy year and are subject to changes due to indexation each year.

As incomes increase (hopefully), shifting from CoverPlus to CoverPlus Extra allows farmers to reduce their cover to a level that matches their perceived level of risk and gives some control over the ACC premium cost.

Alternatively, when faced with a decreasing income or a loss, is there enough ACC cover to provide replacement labour on the farm?

If the accident suffered is severe enough that the farmer is unable to continue farming, or even working, is the level of cover enough to provide for the family's living costs going forward?

Raising a family and paying rent or a mortgage is going to be difficult on the minimum cover of $24,544 per annum.

The ACC conversation needs to be had with clients on a regular basis so that their level of cover is kept appropriate for their changing needs.