

# Client Newsletter

May & June 2010

## Tax Deductibility of Legal Expenses

The Income Tax Act 2007 was amended in 2009, introducing a new piece of legislation (section DB 62) that affects the deductibility of legal expenses, effective from the 2009-2010 income year.

This section states that legal expenses are deductible -

- (a) where a person's total legal expense for the year is equal to or less than \$10,000;
- (b) where the legal expense is for legal services provided by a person holding a practising certificate issued by the New Zealand Law Society or an equivalent body in Australia;
- (c) and can include legal expenses incurred both in relation to capital expenditure as well as revenue expenditure.

The last point effectively means that if a person's legal expense for the income year totals \$10,000 or less, there is no requirement to identify that portion of the legal expenses which relates to capital. This will no doubt reduce the compliance time in analysing the legal fees.

A couple of points to note though -

- The \$10,000 is an annual threshold and not an annual allowance. Therefore, if a person incurs legal expenses during the year that collectively total more than \$10,000, there still remains the requirement to analyse the expenditure that relates to capital items as opposed to those relating to the revenue items, as only the fees relating to the revenue items are deductible.
- The general permission criterion still has to be met to allow the deductibility of legal fees. This requires a nexus between incurring the deduction and deriving assessable income or carrying on a business for the purpose of deriving assessable income. For example, selling a business does not normally generate income. It may generate depreciation recoveries, but as the earning process of the business is the actual operation of the business, and not the buying and selling of businesses, no assessable income is derived from the sale. Therefore, there is no tax deduction for legal fees that might be incurred on the sale of a business. This is supported by Case G50 (1985) 7 NZEC 1,1212.

## Changes in RWT Rates for Investments

The rates of tax on interest earned from money in the bank and portfolio investment entity (PIE) investments have changed effective from 1 April 2010 to align with the personal and company tax rate changes introduced in April 2009.

Depending on the circumstances, a taxpayer may be affected by the RWT (resident withholding tax) and PIE tax rate changes. It is a good time to check whether you or your company is using the correct RWT rate or PIR. The rate an individual uses is dependent on his or her annual income.

Examples of situations where taxpayers will be affected by the changes include:

- If taxpayers are currently using the 19.5% tax rate, their financial institution or bank will automatically change the RWT rate or prescribed investor rate (PIR) to 21% from 1 April 2010.
- If taxpayers have a reasonable expectation of earning \$14,000 or less from all sources for the tax year 1 April 2010 to 31 March 2011, they can change their RWT rate to 12.5% from 1 April 2010.
- If taxpayers fail to provide their financial institution or bank with their IRD number, or don't elect an RWT rate for new bank accounts opened from 1 April 2010, they will have RWT deducted from the new account at the new notification rate of 38%.
- For a company, the financial institution or bank may deduct RWT at a lower rate of 30% from 1 April 2010. All financial institutions and banks will be required to use this new rate from 1 April 2011.
- Trustees with PIE investments can elect their PIR as 0%, 21% or 30%. The lower tax rates will enable income distributions with the appropriate tax credits to beneficiaries on lower tax rates.

If you want to change your RWT rate or PIR and know what your new rate should be (refer to the tables below), please contact your financial institution or bank.

## Changes to Personal Tax Rates

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 introduces changes to:

- personal secondary income tax
- portfolio investment entities (PIEs) and resident withholding tax (RWT) rates
- the taxing of lump sum payments from employers.

These changes take effect from 1 April 2010.

### Personal secondary income tax rate and threshold changes

A new Secondary Bottom (SB) tax code, tax rate and threshold takes effect from 1 April 2010.

#### Previous secondary income rates and thresholds

Income thresholds	Rates	Tax code (no SLS)	Tax code (with SLS)
\$0 - \$48,000	21%	S	S SL
\$48,001 - \$70,000	33%	SH	SH SL
\$70,001 and over	38%	ST	ST SL

#### New secondary income rates and thresholds from 1 April 2010

Income thresholds	Rates	Tax code (no SLS)	Tax code (with SLS)
\$0 - \$14,000	12.5%	SB	SB*
\$14,001 - \$19,084	21%	S	S
\$19,085 - \$48,000	21%	S	S SL
\$48,001 - \$70,000	33%	SH	SH SL
\$70,001 and over	38%	ST	ST SL

### Resident withholding tax (RWT)

Taxable income	Marginal income tax rate	Old RWT tax rate	New RWT tax rate	Application date
\$0 - \$14,000	12.5%	19.5%	12.5%	1/04/2010
\$14,001 - \$48,000	21%	19.5%	21%	1/04/2010
Companies and those taxed as companies	30%	33%	30%	Payers option from 1/04/2010, compulsory from 1/04/2011
\$48,001 - \$70,000	33%	33%	33%	No change
\$70,001 and over	38%	38% or 39%	38%	1/04/2010

### Portfolio investment entities (PIEs)

Taxable income	Taxable income plus PIE income	PIE tax rates
\$0 - \$14,000	\$0 - \$48,000	12.5%
\$0 - \$14,000	\$48,001 - \$70,000	21%
\$14,001 - \$48,000	\$0 - \$70,000	21%
\$48,001 and over	any amount	30%
Any amount	\$70,001 and over	30%

### Taxing lump sum payments

Lump sum payments, also called "extra pays", include:

- annual or special bonuses;
- retiring or redundancy payments;
- payments for accepting restrictive covenants;
- exit inducement payments;
- gratuities; and
- back pay.

Overtime or any regular payments are not lump sum payments.

A new PAYE rate of 14.5% applies from 1 April 2010 for those who have total taxable income of \$14,000 or less.

If a lump sum is paid to a person in relation to their secondary source of income after 1 April 2010 there is a new calculation, which must be used to work out the correct amount of PAYE for that payment.

Important: This is not advice. Clients should not act solely on the basis of the material contained in the *Client Newsletter*. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The *Client Newsletter* is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval. 190/2010.