NTA changes and impact on man day rate

IN MY LAST ARTICLE ABOUT HOW TO ensure a contracting business remains healthy in these changing times, the subject of Non Taxable Allowances was briefly covered, with a warning that the IRD is targeting misuse.

It is worthwhile covering this topic in greater detail as a result of the recent enforcement changes, which has thrown up significant issues affecting contractors' man day rates.

Blackburne Group Chartered Accountants has reviewed the implications of these changes and we've found that to maintain current levels of take-home pay will result in an average increase of man day rates of approximately $20 per person. For a 10-person crew the potential cost amounts to $200 per day or $46,000 per annum.

For the majority of contractors this additional cost is significant, with real potential for added financial stress on contractors to impact other areas of their business, such as Health & Safety, if they are left to just try and increase production (if indeed their annual targets allow) to make up the real financial consequences of these changes.

THE ISSUE – IRD ENFORCEMENTS OF NTA'S

Late in 2014 Inland Revenue (IRD) commenced a detailed review of Non Taxable Allowances (NTA's) being paid by the industry consequent to concerns that had arisen following several audits. NZ Institute of Chartered Accountants identified Mark Blackburne's speciality skills in this area and consequently he became extensively involved in providing expert advice on the issues being investigated. This was useful in reducing issues that might have arisen through misunderstanding resulting in IRD taking a sledgehammer to the problem.

For further commentary on NTA's and chainsaw allowances in particular, the link below to QB 15/08 on the IRD website and also a link to Blackburne Group's April 2015 newsletter provides a useful review of the issues around NTAs:

http://www.ird.govt.nz/technical-tax/questions/questions-general

http://www.blackburnegroup.co.nz/files/4514/4296/2207/NTA_Newsletter_April_15.pdf

In summary, IRD has identified that the industry has a practice of overpaying NTA's, increasing the net take-home pay of employees at the expense of PAYE receipts. This is now an area of focus for the IRD, with justification of allowances being crucial in having them accepted as legitimate deductions to the contractor and as non-taxable in the hands of the employee.

The recently published guideline does not alter the existing law. It does, however, put the industry on notice that current practices are unacceptable and that IRD is going to increase its enforcement. Those who ignore the clear warning to 'tidy up their act' run the risk of significant penalties (refer below).

IRD has also flagged its awareness of the impact of mechanisation and that the 'one size fits all' payment of NTA's is unrealistic and unacceptable. Increased enforcement action has already been carried out in Northland and on the East Coast, and indications are that this will be rolled out throughout the country.

CONSEQUENCES

Historic pressures on contractors to keep the man day rate down resulted in contractors increasing NTA's to preserve the take-home pay of their crews while minimising man day rates included in costings. Effectively, contractors were exposed to a potential IRD liability (in many cases unknowingly) so as to minimise overall man and thereby crew costing rates and remain cost competitive.

With the IRD placing emphasis on this area, our opinion is that contractors will have to increase gross taxable wages to maintain the level of take-home pay necessary to retain key highly skilled staff who are greatly in demand. The required increase in gross pay is magnified in the man day rate due to the multiplying effects of PAYE, holiday pay, Kiwisaver and sick pay.

Reviews of payroll data available indicate that commonly, NTA's may average approximately $30–$40 per person. This could reduce significantly in the new environment. Exact amounts will vary between crews, geographic location, circumstances and individuals within crews.

By Sonya Elmiger, Blackburne Group LP

Contractors are left with three options which can be summarised (based on a 10-person crew and 230 working days) as follows:

1. Do nothing.

Contractors are highly exposed in the new enforcement environment as penalties are significant. Having put the industry on notice, it is likely IRD will be unsympathetic to those who have ignored warnings.

Doing nothing can result in potential minimum per annum costs of $31,158 for the first year with potential ongoing and other costs, i.e. there is nothing to stop IRD backdating penalties for as long as records are available. We are aware of one contractor who has recently been penalised $50,000 following an NTA audit.

While $25 per man day was used for the above calculation of $31,158, there is a distinct possibility that IRD will take a very hard-nosed approach to those that have, in IRD opinion, thumbed their nose at warnings provided. How a contractor (or their accountant) handles the IRD in an audit can be critical as to outcomes.

2. Convert existing NTA to gross taxable income.

NTA's are treated as taxable income with a consequent reduction in take-home pay.

Blackburne Group thinks this is totally

unrealistic as would result in:

- Employment disputes and associated consequences, as employers cannot unilaterally change existing agreements without employee consent, which it is difficult to see being received
- Loss of experienced staff who are greatly in demand with good workers having plenty of work options.

In our experience, forestry employees are EXTREMELY sensitive to levels of take-home pay and any adverse adjustments will have inevitable consequences. Even contractors who have increased gross pay to maintain notional take-home wages can lose staff, as while employees still receive the same take-home pay some are negatively impacted by increased liable parent/court fine/student loan deductions as gross taxable wage increases.

3. Reduce NTA & increase gross taxable wage to maintain take-home pay.

This option results in a direct (additional) cost to the contractor of $46,000 per annum, or just on $20 per man day if the costed man day rate averages approximately $300 per person per day.

CONCLUSION

Demand for the increasingly skilled operators, senior staff and foreman required by the industry is great, so likely this is a minimum in many cases. There are continual anecdotal references from contractors as to the difficulties of obtaining experienced and motivated workers.

In addition to the above possible $20 costs, there are ongoing pressures to increase rates to reflect demand for skilled workers. A combination of these factors suggest there may, in many cases, be a need for up to a 10% increase in costed man day rates to reflect a real increase in costs from the NTA issues, plus market forces and demand for skilled labour.

While this is a difficult topic for many contractors and forestry managers, it is one that the industry has been hiding from for many years and is now out in the open and needs to be addressed and resolved through appropriate rate adjustments.

If YOU do not take control of the situation now then there is a good chance that IRD (eventually) will. NZL

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