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NEWSLETTER

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Agent vs Principal

An agency relationship exists where one person (the agent) acts or appears to act on behalf of another person (the principal). However, it is not always clear that an agency relationship exists. There are various situations that can arise in a commercial context and it is important to correctly determine the capacity in which a person is acting so that each party can account for the situation correctly. This depends on the particular circumstances of each supply.

The following factors indicate a vendor is supplying goods/services as an agent:

- Another person will be bound by the vendor's actions,
- The vendors ability to negotiate the terms and conditions of sale are limited pursuant to an agreement with another person,
- Another person is financially liable for the vendor's actions,
- The vendor is limited in their ability to affect the profit derived from a transaction as they are paid on a fixed or commission type arrangement,
- Another person will be responsible for remedies/refunds due to the supply of unsatisfactory goods/services,
- The vendor does not set the price of the goods/services supplied,
- If the customer does not pay, another person would sue the customer and not the vendor.

A person's capacity for GST purposes must also be determined because it is the principal that must account for a transaction, not the agent. For example, supplies provided by a person to an agent are deemed to be made to the principal and not the agent. Conversely, supplies provided by an agent are deemed to be made by the principal. A common example is where an employee incurs expenses on their employer's behalf. The agency provisions enable the employer to claim the GST input tax, even though the invoice is addressed to the employee.

A common source of confusion is supplier invoices, which narrate either expenses incurred by the supplier or the supplier's disbursements. For example, a

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business contracts with a broker to arrange for the importation of goods. The broker is GST registered and their services are subject to GST at 15%. To arrange importation of the goods, the broker incurs various costs including international airfares. When the broker's invoice is received, it details the costs incurred by the broker including the international airfare. A dispute arises because the business owner believes international airfares are subject to GST at 0% and therefore that portion of the broker's cost should not be subject to GST.

The zero rating provisions do provide that international airfares are zero rated. However, the broker is not supplying an airfare to the business. The broker is assisting the business with the importation of goods. The international airfare is an expense incurred by the

broker to provide their service, which is subject to GST at 15%.

If however, the broker was acting as agent for the business and the charge for the airfare was thereby more akin to a reimbursement, the business would pay the broker based on the underlying GST rate, i.e. 0%.

The contracting parties often rely on the terms of a contract that may explicitly state whether or not the relationship is that of an agent. However, the Courts will take into account the rights and responsibilities of each party and have been known to reach a different conclusion than those prescribed in a contract. As each situation is different, care must be taken to determine the correct tax treatment on a case by case basis.

Business Development Basics

A commonly held marketing statistic reveals that, on average, businesses spend the majority of their marketing dollar prospecting for new customers compared to nurturing and developing relationships with current customers. These statistics also tell us that on average it can cost six to seven times more to sell something to a prospect than to sell that same thing to a current customer, and that repeat customers spend 33% more than new customers. Although these statistics are observing general trends, it is worth taking the time to evaluate whether you are effectively nurturing current customers in a way that develops the opportunities that exist for repeat and new business. This could be a key to unlocking growth that is right in front of you.



Some of the more recent marketing thinking views the value or benefit of a 'good or service' as being 'co-created' with customers through strong relationships and collaborative business development. To this end, Relationship Marketing focuses on the development of market or industry sector strategies, creating profitable partnerships and long term relationships with both customers and suppliers.

The following provides some basic pointers in developing this area of your marketing thrust:

- research and intelligence gathering on customers and competitors,
- the development of more personal or direct networks that lead to referrals or sales,
- leading/overseeing formal proposal or presentation opportunities,

- developing plans for winning new work from existing or target customers,
- developing plans that focus on existing customer satisfaction, retention and growth, and
- creating a customer-centric culture across the business.

As the name suggests, relationship marketing is more of a customer or market facing role so having strong interpersonal skills in support of the above actions will have a significant influence on the success of your marketing activities.

There are a number of tips listed below that may be useful to you depending on the product or service your business is involved in.

- **Relationship building should be everyone's responsibility** – regardless of role make sure everyone knows about the business so they can confidently communicate this information to others. Share details with colleagues about products and services, strategy, performance, successes and industry trends. Communicate internally on a regular basis and recognise those who excel.
- **Value all business relationships** – you never know what the people you meet today will be doing tomorrow, so treat everyone you meet with respect. Today you may not consider someone to be influential but tomorrow they could be your customer, so don't leave them with a negative first impression.
- **Have a robust process for proposals/tendering** – not all formal opportunities are worth investing significant resources on, so ensure you have a tested and robust process around the "do we or don't we" question. Consider the likelihood of winning, strategic fit, profitability and how well you know the decision makers.
- **Your best customer is the one you already have** – never take existing customers for granted. Take the

time to get to know them and their business to enhance the relationship. You will increase opportunities to win more business and receive referrals from customers that value your efforts.

- **Meet before you propose** – you will increase your chances of success with current or potential customers if you have met them face-to-face. Prepare well for the meeting and you will learn valuable information that your competition may not be aware of. Don't forget to listen more than you speak.
- **Report card** – whether you win or lose a specific piece of business or new customer opportunity

PAYE vs FBT

PAYE generally applies to cash paid by an employer to an employee, while FBT applies to non-cash benefits provided by the employer to the employee. However, it is not always clear whether PAYE, FBT or neither applies.

The basis upon which an employee receives a benefit will determine how it should be treated. For example, to reward an employee for their efforts an employer pays for an employee to attend an educational course of their choice, and the employee chooses to attend a cooking course for their own personal interest. In doing so, any one of the following scenarios could apply:

1. The employee organises to attend the course, receives the invoice and pays the cost, but is reimbursed by the employer.
2. The employee organises to attend the course and receives the invoice, but the employer pays the invoice on the employee's behalf.
3. The employer organises the course, receives the invoice and pays for the cost of the course.

The reimbursement payment under the first scenario will be subject to PAYE as it is akin to an additional salary/wages payment. In the second scenario, as the expense has been incurred by the employee (i.e. the invoice is in the employee's name), upon payment by the employer it is specifically captured as "expenditure on account of an employee" and also subject to PAYE. The third scenario is distinguished from the first two scenarios, on the basis that the employer contracts to procure the right for the employee to attend the course directly and provides that right to the employee, i.e. a non-cash benefit, and is therefore subject to FBT.

Making the Most of the 90-Day Trial Period

The new Employment Relations Amendment Act 2010, which came into effect on 1 April 2011, extended the 90-day trial period to all employers; prior to the amendment only those with fewer than 20 staff qualified.

The Employment Relations Act legislation requires that in order for a trial period provision in an employment

agreement to be valid, the agreement must be in writing and state:

• that it is for a specific period not exceeding 90 days starting at the beginning of the employment, and

• that during the period the employer may dismiss the employee, and

always ask for a post-decision debrief. You will learn what you did well and not so well to ensure future success.

Given that you will spend significantly more to find new customers compared to maintaining and obtaining repeat business from current customers, it makes good business sense to grow and enhance the relationships that you have already spent time and money on establishing in the first place.

However, if instead of a cooking course the employer required the employee to attend a leadership development course, under each scenario above, no FBT or PAYE would be payable.

In the first scenario, a reimbursement payment is not subject to PAYE if the reimbursement qualifies as a non-taxable reimbursement. To qualify as a non-taxable reimbursement, the course would have to be deemed to have developed the employee's capacity to perform their job. On this basis, the payment would qualify as a tax-free reimbursement not subject to PAYE.



In the second scenario, the payment for the course is not captured as expenditure on account of an employee as it is for the benefit of the employer's business and therefore is not subject to PAYE. In the third scenario, because the benefit removes the need for the employer to pay a non-taxable reimbursement, FBT does not apply.

It is important to consider all the facts when determining if PAYE or FBT apply. It must be established whether the employer or the employee is incurring the underlying expense, and whether the employer benefits from the expense or if it is of personal benefit to the employee.

- if the employee is dismissed they are not entitled to bring a personal grievance or other legal proceedings in respect of the dismissal.

If any of these elements are missing the trial period is not valid. In addition, the trial period provision provides that the employee has not previously been employed by the employer.

Since the enactment of the trial period provision, there have been several cases heard through the employment courts that give some clarity of interpretation of this legislation.

In *Parkes v Squires Manufacturing Ltd*, a recent personal grievance case, the employee received her employment agreement before starting work and signed it at lunchtime on her first day of work. The employer signed it a week later. The Employment Authority found that, as the employee had already started before signing the agreement, the trial period clause was not valid.

In *Smith v Stokes Valley Pharmacy (2009) Limited*, the Employment Court tested the 90-day trial period and applied a very rigid interpretation, which now provides the ground rules for employers. The court concluded that the employment agreement must include the trial period provisions (as stated above) and must be signed by both parties before the commencement of the employment.



It was also concluded in the *Smith v Stokes Valley Pharmacy* case that although the employee cannot claim wrongful dismissal, they are still entitled to the protection of the good faith provisions of the Employment Relations Act. These require the employer and employee to be communicative and responsive in their relationship. The employer is not required to give reasons for the dismissal in writing but they are required to give the employee feedback so that they can learn from the unsuccessful trial and hopefully have greater success with their next role.

The Judge also looked at the issue of notice with respect to the trial period and concluded that notice can be given during the 90-day period for the employment to terminate after the 90 days. However, in the event of an unsuccessful trial there is no provision for 'payment in lieu of notice' or 'termination without notice'. Thus the notice period must be worked out, unless the parties agree to it being paid in lieu at the time that the employee is given notice.

In essence, the trial period provides a level of protection if you have sincerely endeavoured to meet the standards expected of a "fair and reasonable" employer.

Snippets

Earthquake Relief – Donation of Trading Stock

Currently, if a business makes a donation of trading stock, it is deemed to be sold for market value and tax is payable accordingly. To support businesses who have or wish to make donations in support of the victims of the Christchurch earthquakes, the Government has introduced draft legislation exempting donations of trading stock from this market value rule.



The draft legislation provides disposals of trading stock will be exempt if it has been disposed of:

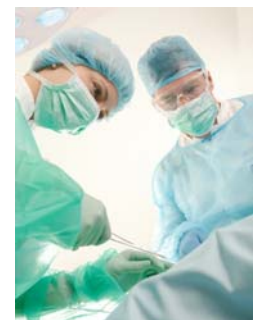
- to an unassociated person,
- for the purpose of relief from the adverse effects of a Canterbury earthquake, and
- the donation is made between 4 September 2010 and 31 March 2012.

A similar exclusion from gift duty has also been included in the draft legislation.

Update: Penny & Hooper v CIR

Penny & Hooper is a landmark case involving two orthopaedic surgeons operating through companies and not receiving "commercially realistic salaries".

The case was originally found in favour of the IRD by the Taxation Review Authority and later overturned by the High Court. In June 2010 the Court of Appeal swung in favour of the IRD. The taxpayers appealed to the Supreme Court.



The hearing by the Supreme Court of the appeal by Penny & Hooper has been delayed until 28 & 29 June 2011. The case was due to be heard by the Supreme Court in early March 2011, but this has been rescheduled due to the Christchurch earthquake.

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