

Newsletter

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Main Points of 2010 Budget

What a difference a year makes. The 2010 Budget was announced on 20 May 2010, bringing in far-reaching changes. Outlined below are the more topical changes.

Personal Tax Cuts

The Budget delivered reductions to all personal tax rates, effective from 1 October 2010, with the main surprise being the reduction of the 33% rate to 30%. The reduction to the rates means that someone earning \$45,000 p.a. would receive an additional \$26 in the pocket each week, while someone earning \$70,000 stands to receive an additional \$41 a week. These increases do not take into account the effect of the GST increase.



The top personal tax from 38% to 33% to trustee tax rate. This removed the tax savings achieved for income \$70,000 p.a. by having a

an individual deriving the income. With the tax changes it may be timely to review structures that are in place. The benefits of a trust, such as asset protection and estate planning, still remain and need consideration.

rate was reduced align with the has effectively that could be earned above trust instead of

Working For Families Changes

The Budget has made a number of changes to the qualification criteria for Working For Families ('WFF') assistance. The automatic increasing of the Family Tax Credit abatement threshold (to compensate for inflation) has been removed. The abatement threshold will remain at \$36,827 unless the Government makes a change to the threshold. One effect of this change is that over time fewer families will qualify for WFF assistance as families' incomes exceed the qualification threshold.

The Government has proposed that from 1 April 2011, investment losses will not be taken into account when determining a family's income for

WFF purposes. This will prevent a person from using losses, for example from a rental property, to increase their WFF entitlement. It is also likely that from 1 April 2011 all distributions from trusts will be taken into account, as well

Loss Attributing Qualifying Companies (LAQCs) & Qualifying Companies (QCs)

The Budget outlined intended changes to both LAQCs and QCs, which will result in them being treated similarly to partnerships. These changes are planned to be effective from 1 April 2011.

Any profit or loss derived by the LAQC/QC will flow through to the shareholders in proportion to their shareholding. The shareholders will then be taxed on the income attributed to them at their marginal tax rates. QCs will be required to file an IR7 partnership tax return instead of an IR4 company tax return.

On transition from an 'old' LAQC/QC to a 'new' QC, the imputation credit balance of the 'old' LAQC/QC will be extinguished. The payment of a dividend to utilise the imputation credits before they are extinguished should be considered keeping in mind how much cash is available in the LAQC/QC. A taxable bonus issue could be considered if cash is a problem.

Any losses currently held in a QC will be 'ring-fenced' from

as PIE income and the value of fringe benefits received from employment. This will further reduce the amount of entitlement families are eligible to receive.

the date the new rules take effect and will only be able to be used to off-set future profits the QC derives. This is not an issue for LAQCs as losses are always attributed to shareholders on an annual basis. Loss limitation rules will apply to limit the losses attributed to a shareholder to the extent of their investment in the 'new' QC.

Once the new rules take effect, any sale of shares in a QC will be a deemed disposition of the underlying property held by the QC. This creates potential tax consequences, such as depreciation recovery for the vendor, as well as having assets at different values for different shareholders.

If an LAQC/QC is expecting to make profits in the future it may be worthwhile exiting the QC regime to prevent the profits flowing directly to the shareholders. It would also be advisable to exit the regime before 1 April 2011 (the likely date of change) otherwise there could be a deemed disposal of the QC's underlying assets if the exit is on 1 April 2011 or later.

Company Tax Rate Change

The company tax rate will drop from 30% to 28% at the start of a company's 2011/2012 income tax year. This could be as early as October 2010 for companies with early balance dates.

The change in the corporate tax rate means the standard uplift rates for provisional tax are on the back-burner once again. If you are basing 2011/2012 provisional tax on last year's tax return there is no uplift (i.e. use 100% of past year's RIT). If you are basing 2011/2012 provisional tax on your 2009/2010 tax return then use an uplift of 105%.

Depreciation

Depreciation deductions on buildings with an estimated useful life of 50 years or more will be removed from the 2011/2012 income year. The depreciation rate on these buildings will be reduced to 0%.

Other buildings (with a useful life of less than 50 years) will still be able to be depreciated if they have an IRD prescribed depreciation rate e.g. dairy sheds and hot-houses.

Even though many buildings can no longer be depreciated, depreciation recovery will still apply for those buildings when they are sold for greater than their book values.



Any asset purchased from 21 May 2010 onwards is not entitled to the 20% depreciation loading. However, if a contract to purchase the asset was entered into prior to 21 May 2010 then that asset can still be depreciated with the loading.

Any asset being depreciated at a rate with loading before 21 May 2010 can continue to be depreciated at that rate for that asset's lifetime. However, if there is a capital improvement to the asset, that improvement will need to be depreciated separately from the original asset without the loading.

GST

The increase in GST from 12.5% to 15% requires a range of systems changes and checks. Whether GST on a sale should be at the old or new rate will depend on whether the time of supply is before, or from 1 October 2010. If you are on the invoice basis, the time of supply is triggered by the earlier of receiving a payment or issuing a tax invoice. This means the old rate can be locked in for a customer purchasing goods to be received after 1 October 2010 by the customer paying a deposit before 1 October 2010.

For those on the payments basis, debtors and creditors existing at the time of the change are subject to a notional 2.5% conversion at their values on the date of transition, with all payments or receipts thereafter being subject to 15%. The notional conversion has the effect of deeming payments or receipts relating to prior to the rate increase to be at a net 12.5%.

GST: 15%

If 1 October 2010 comes part way through your GST period, two GST returns must be completed, i.e. one return for supplies made to 30 September 2010 and a second return for supplies from 1 October 2010. The IRD will provide a special form for the additional GST return.

You will need to ensure your systems can deal with two GST rates for a period of time. Credit notes issued post 1 October for purchases made pre 1 October will need to be issued using the old rate. Systems set-up to automatically code repeat transactions will need to be reviewed or switched to manual coding during the transitional period to ensure the correct GST rate is accounted for.

Where goods and services are paid for by progress payments, e.g. insurance or rates, each payment is deemed to be a separate supply. Therefore, the GST on a progress payment made after 1 October 2010 will need to have GST charged at 15%.

Paying Income Tax from Trading

It is well known that the IRD have comprehensive powers to request information for the purposes of enforcing the collection of tax. A recent project by the IRD saw those powers directed at identification of on-line traders (using auction websites such as TradeMe) who collectively had not paid over \$1.2 Million of tax over the past three years.

The IRD website advises that as a "general guide", business income from trading online should be declared (and taxed) if:

- the goods were acquired for the purpose of on-selling,
- the purpose of the activity is to make a profit, or
- the business involves dealing in these goods.

It is important to note that, despite the fact that the IRD's message is specifically in the context of on-line trading, the same principles can be applied to all types of trading activities.

Irrespective of what a person is doing, whether it is on-line or otherwise, the IRD is likely to apply one of two criteria, namely:

- have goods been purchased with a purpose of resale, or
- does the level of activity indicate that a business exists.

If either criterion applies all profits from the trading are taxable.

In order to determine "purpose", the IRD is likely to rely on documentary evidence. Without evidence it becomes an argument over a person's intention, which is difficult to establish at the best of times. If a person does not have a purpose of resale the IRD could instead argue that a business exists, which case law has shown can be proven on the facts of a particular case. As stated in the Court of Appeal decision of *Grieve v Commissioner of Inland Revenue* in 1984, "whether a business existed turned on the intention of the taxpayer as evidenced by his conduct".

In the *Grieve* case the taxpayers had to prove that their farming activities were a business in the 1976 and 1977 income years, even though it had been operating at a loss. The result was a thorough analysis of what, in the context of the Income Tax Act, is meant by the term "business". The tests arrived at by the Court are:

- statements by the taxpayer as to intention
- the nature of the activity
- the period over which the activity is engaged
- the scale of operations and the volume of transactions
- the commitment of time, money and effort
- the pattern of activity
- the financial results
- whether the activity is run in the same way as other businesses in that particular trade

It is better to consider the tests above, reach your own conclusion and gather evidence that a business exists, before the IRD come knocking on your door.

Cash Flow Forecasts and Budgets

It is often said that “failing to plan is like planning to fail”. In today’s economic climate the need to plan is critical to the ongoing success, and in some instances survival, of your business. Two effective tools for planning are budgets and cash flow forecasts.

A budget encourages you to look forward and forecast what your income and expenses will be for the upcoming year. Once the budget is set, regular comparisons against actual performance will enable you to investigate any variances and take action where necessary. This pro-active approach will help you to make informed decisions.

The budget can be used to help you start planning for your cash commitments. However profitable your business may appear to be, cash is still the lifeblood of any organisation. Common questions asked by business owners are, “if the business made a profit for the year why does the bank balance not reflect this?” and “where has the money gone?” Unfortunately sales do not always equal cash and this can make it difficult when it comes time to pay the bills. Collection of cash from customers can at times prove challenging. Likewise, business owners need to be able to live, and often drawings are overlooked when it comes to cash management.

A cash flow forecast enables you to anticipate any shortfalls that may occur and to make plans accordingly. For example, if it looks like cash is going to be tight when a taxation payment is due, there are various options available to you to minimise underpayment penalties and interest – whether



it be organising a payment plan with Inland Revenue or purchasing tax from a tax intermediary. The cash flow forecast can also indicate whether you may need to review your current banking arrangements. Perhaps you may need to re-negotiate payment terms with your suppliers or introduce measures to encourage debtors to part with their cash earlier, such as early payment discounts or penalty interest for late payments.

Regularly reviewing your liquidity and where your business is at financially will also mean that when the bank manager requests this information you have it on hand. As banks are becoming more cautious with their lending, there has been an increase in the request for up-to-date financial information. If you are able to produce budgets and cash flow forecasts for your bank manager in a timely manner it demonstrates you have a good grasp on the financial state of your business. Of course the quality of this financial information is crucial. It would be a wise move to engage an accountant like ourselves, to assist you with this process.

There are numerous tools that can be used to prepare budgets and cash flow forecasts, whether they are part of your current accounting system, an excel spreadsheet or a more sophisticated specialist piece of software. What is important is that they do become an integral part of your business planning.

Please contact us here at Ulrich+Kippenberger if you need assistance with preparing Budgets and Cash Flow Forecasts. We can prepare projected Profit and Loss and Balance Sheet reports for five years or more, if required.

Snippets

IRD Recording Interviews

The IRD is increasingly conducting interviews using audio recording technology, and has recently sought feedback on its Standard Practice Statement (SPS) for recording interviews with taxpayers.

It is important to note that most interviews are voluntary. The only exception is a compulsory interview under section 19 of the Tax Administration Act (provision for the IRD to require a person to give evidence). These are always electronically recorded, using video recording technology in appropriate cases, and the interviewee’s consent is not required. However, attendance by the taxpayer at initial

investigation meetings and follow up meetings is generally voluntary in nature.

Excluding section 19 interviews, a taxpayer will be asked before the interview if they consent to the interview being recorded. The taxpayer has the right under the Privacy Act 1993 to not consent to the interview being recorded. The reasons behind the refusal are not important and the taxpayer is not required to justify their decision to refuse. The draft SPS advises that the IRD will respect the taxpayer’s decisions.

If you have any questions about the newsletter items, please contact your team at Ulrich+Kippenberger.
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