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Newsletter

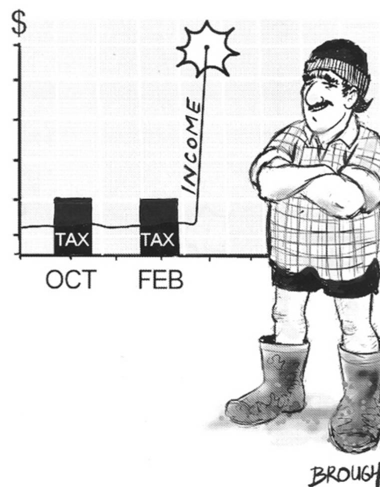
SUMMER 2007

The GST ratio

FROM the beginning of the 2008 financial year, business entities paying GST and provisional income tax will be permitted to pay provisional tax based on their sales*. The idea is simple.
Calculate the ratio of tax payable to sales made for the last year. If sales were $200,000 and tax payable was $7000, the ratio would be $7000/200,000 = 3.5%. Apply this ratio to the sales declared in your GST return.
Thus, if your sales for a two-month period were $30,000, then your provisional tax payment would be 3.5% of $30,000 = $1050. You would pay this with your GST.

Why would you want to use the GST ratio?
The advantages of the GST ratio are:

- If your business is seasonal, you will pay your provisional tax based on when you get your money. Currently, provisional tax has to be paid in three equal instalments, regardless of whether you have the money to pay.
- It will help with cash-flow management. Your provisional tax is better spread out during the year.
- Here's the big one. If you use the GST ratio, you are no longer liable to pay Use of Money Interest (UOMI) if your provisional tax payments turn out to be insufficient. If your business gets a surge in income, the GST ratio would save you from becoming liable for UOMI, which is currently charged at 14.24% and back-dated to when the first instalment of provisional tax was due. Look ahead. It might pay to use the GST ratio.



Downsides of the GST ratio are:
It is available only to those entities which pay GST and also pay provisional tax. It rules out:

- Partnerships, because it is the partners who pay the income tax. Partnerships do not pay tax.
- Companies which distribute all their income to shareholders, because it is the company which pays GST and the shareholders who pay the tax.
- People caught by the attribution rule. They have to attribute their company income to the shareholders. They are the ones who derive their income from personal services to just one customer or related customers. The company pays GST but does not pay provisional income tax.

Other issues

- If you want to use the GST ratio, you have to apply to IRD **before** the start of your financial year. You must pay GST at least six times a year.
- If your business has an annual tax bill (called Residual Income Tax) of more than $150,000, you are not allowed to use the GST ratio. You may, of course, deduct shareholder wages before arriving at the taxable profit for a company.

A thought
If you pay all company profits to shareholders but expect UOMI could become a problem, you could make your company a provisional tax payer and register for the GST ratio. You would need to leave a profit of at least $7576 in your company.

Note
*You pay your provisional tax on the basis of all sales, including asset sales. You may adjust for the asset sales if the amount is large.

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Different powers of attorney

ONE of our older clients, who takes regular overseas holidays, came in to see us recently. We were reviewing his annual accounts and the conversation turned to other matters he should be thinking about.

"Have you given anyone a power of attorney so your affairs could be administered in your absence?" we asked. He had taken care of this.

We then took a moment to acquaint him with the "enduring power of attorney". This covers you if you are too sick to make decisions for yourself. The ordinary P of A enables someone to act for you, so long as you have not "lost your mental capacity"; but what happens if you have?

"What if you were too ill to handle your own affairs or you needed special care?" we asked. "Your power of attorney would be no use."

He was surprised when we told him this. "You need an enduring power of attorney," we said. "There are two types. One relates to your personal care and welfare. You can give this to only one person.

"The other, which could be given to more than one person acting jointly, covers you so your property, bank accounts etc can be dealt with. If you want to specify the type of property you are prepared to entrust to your EP of A, you may. Anything you leave out might have to be dealt with through a court and you might not like the outcome."

Check any powers of attorney you have issued. Will they do everything you wish? Be careful who you choose for your EP of A. Bad choices are all too common and can lead to litigation.

Tax rates for PIEs

A PORTFOLIO Investment Entity (PIE) is a managed fund which has tax privileges but which must abide by certain recently created laws.

If you invest in a PIE, at the beginning of each financial year you will get a form asking you for your tax rate. How do you know what to write on the form? We list the rules below:

Individuals

You may choose a tax rate of 19.5% if your income is less than $38,000 and your share of income from the PIE, when added to your own income, is less than $60,000. Since PIEs came into existence only on 1 October 2007, PIE income will not be included for the year starting on 1 April 2008 because no one will have a full year of PIE income.

Provided you have satisfied these conditions **in either** of the last two years, you are entitled to use the 19.5% tax rate. For the year starting 1 April 2008, the last two years are 31 March 2006 and 31 March 2007.

If you understate your rate, you have to complete a tax return and take the PIE income into it. You get credit for tax deducted by the PIE but the income could affect student loan payments, child support etc.

If your income is above these thresholds your rate is 33%.

Joint investments

If you invest jointly, split the investments between you, so you can use your own tax rates. If you invest **jointly** and have different rates, you have to select the higher one and the overpaid tax is not refundable.

Companies

Companies always use the 33% tax rate.

Trusts

You may choose either zero or 33%. If your trust distributes income to beneficiaries, choose the zero rate if the beneficiaries will be paying tax at 19.5% on the money they get.

Pay out dividends

THE tax rates for companies will be reduced to 30% from the start of the 2009 tax year (for 31 March balances this is 1 April 2008).

When dividends are declared out of these profits, they will carry an imputation credit of only 30%.

The Government realises there are accumulated imputation credits from past years and these represent tax paid at 33%. If you want to use up these 33% credits, you have until 31 March 2010 to do so. After that, all tax credits attaching to dividends will be at 30%.

If a family trust owns most of your company shares, consider paying the dividends as soon as possible, unless you think the tax rate for trusts will be reduced.

If individuals own the company shares it could be wise to wait for the next Budget to see if you can declare a dividend in a lower tax year.

Business cards

YOUR business card is an advertisement.

Remember the rules for good advertisements when designing your card.

- State the principal benefit you have to offer, for example, specialists (or experts) in …
- Can you include a picture? It is worth a thousand words!
- Keep to the standard size. Big cards are a pain and deserve to be thrown away.
- If you want to put more on the card than you have room for, use the back. You might wish to list your best products.
- Supply all your contact details, especially your email address. Put them at the bottom of the card. From a customer's perspective, what you have to offer is more important than you are.

Foreign company shareholdings of less than 10%

IF you hold any company shares other than those in New Zealand companies and certain Australian companies, you will be liable, when you complete your 2008 tax return, for a new tax called the Fair Dividend Rate (FDR).

There is only one concession. If you own the shares, excluding the exceptions mentioned above, **in your own name** and they cost less than $50,000 you do not need to read any further.

If you have owned the shares since before 1 January 2000, you do not need to know what they cost you. Use the **value** (discuss the meaning of this term with us) at 31 March 2007 as their cost. The concession for these old shares is doubled.

Note: **There is no $50,000 relief for a family trust.**

If this law change affects you, you need to do two things now:-

1. Find out what your shares were worth on the first day of your financial year. For most people this is the 1 April 2007.
2. If you are going to be liable for FDR, ring us to discuss, because you might find you should be paying provisional tax.

What is Fair Dividend Rate?

Many overseas companies pay only small dividends or none at all. The Government was not getting a fair share of tax on its income by taxing only dividends. It has therefore decided to treat 5% of value of the shares as though it were a dividend.

FDR is more complicated than it appears, so we are not proposing to discuss it in detail in this newsletter.

For example, Australian companies, which do not pay tax on all their income because of a tie up with a foreign company, are also subject to the Fair Dividend Rate as are shares in unlisted Australian companies.

Do you want to be a trustee?

IF you are invited to be a trustee of a family trust, should you accept?

Trustees are personally responsible to the beneficiaries of the trust and could be sued by them for any breach of trust. This means any failure to comply with the Trust Deed.

Actions against trustees can occur many years later, and it might be the partner of one of the younger generation who encourages the beneficiary to get difficult.

A Trust Deed is a document which sets out the wishes of the person who formed the trust. Trustees must know what the Trust Deed says.

When trustees make decisions they do so together. They make decisions and then they carry them out.

This means if there are three trustees, and two of them make a decision, it is likely to be invalid.

You cannot make it valid by getting the third trustee to sign the minute, later. This is because the third trustee was not involved in making the decision. Trustees should be careful to act properly.

Do you still want to accept the office of trustee? If in doubt, decline.

•IN BRIEF

Filing GST returns

A CLIENT filed an electronic GST return on 2 April 2007. IRD said it had never received it. Keep receipts for electronic filing. A penalty system is coming in for late GST returns. The first time you offend you will get a warning. Those people posting in GST returns must send the whole form. Some people have been sending only the payment slip because the form no longer has a copy.

Unclaimed tax refunds

IF you go to the IRD website and click on individuals and families, you will find a drop-down menu. Go to unclaimed monies and you will find a list of people who have not claimed their tax refunds. If you know anyone on this list, tell them they can claim their refund by writing to:

Business Direct,
IRD,
PO Box 895,
Wellington.

They will need to provide the following information:-

- Personal identification
- Evidence they have authority to claim the refund
- Time slips or other evidence to show they worked for the firm concerned if the refund is arising out of wages.

People who do not work for all of any financial year are likely to be over taxed.

Four weeks holidays

IF the firm has an annual shut-down, the employer can require employees to use whatever annual holidays they have left during a close-down period.

Log book reminder

IF you need to keep a log book, remember you have to do this every three years for a three-month period.

Borrowing money for your business

IF you borrow money to buy shares in any business, the interest is tax deductible provided the shares will yield dividends at some time in the future. However, most borrowed money takes the form of a loan to the business. It is not for purchasing the shares.

Sometimes banks make their loans to the shareholders, instead of the company. If this happens, the interest is not a tax-deductible cost to the company. To be tax deductible, the shareholders must be able to show the interest they pay gives rise, directly, to income for **them**. The company profit is not the shareholders' income. It belongs to the company. **It is therefore better for the loan to be to the company.**

Shareholder salaries do not help you to claim the interest, because costs relating to salaries, with two exceptions, are not tax deductible.

The solution is an agreement with the company for the shareholders to lend it money. The company must pay a higher rate of interest to shareholders than the bank is charging them. The bank loan is now generating a profit for the shareholders so they can claim the interest and declare their profit. The company can claim a tax deduction for the interest it pays the shareholders.

TAX CALENDAR

November 7
2nd instalment 2008
Provisional Tax
(March balance date)
2007 Terminal Tax
(October balance date)

December 7
3rd instalment 2008
Provisional Tax
(December balance date)

January 15
GST November 2007
2007 Terminal Tax
(December balance date)

February 7
2nd instalment 2008
Provisional Tax
(June balance date)

New insolvency law

INSOLVENCY law is being changed to allow companies in financial difficulties to trade out of them. The process is called voluntary administration.

Secured creditors or a court can place a company into voluntary administration. Creditors can then vote on allowing the company to trade out, or they can have it wound up. Decisions are made on the basis of 50% of the creditors (having at least 75% of the debt between them) approving the arrangement.

The problem is the IRD. It gets preference in a winding-up. The accumulation of interest and penalties could see its debt exceed 25% of the total value. It could prefer winding up.

No asset procedure

Bankruptcy law is also being changed.

If a person cannot pay his/her debts and has not previously been bankrupt or used the scheme, he/she can be forgiven the debts and, after 12 months, start afresh.

To qualify for this scheme, one of the conditions is that the debtor must have total assets of $1000 to $40,000.

Car FBT calculation

BE careful to get your FBT calculation right for a company car. Take the actual number of days in a quarter - say 91. Deduct the days the vehicle was **not** available for private use. The result is then divided by 90 and multiplied by 5% of the GST inclusive cost price of the car. This is the value of the benefit.

Unsolicited electronic messages (spam)

The following is the briefest of summaries to help you understand the new spam law.

What's included?
- Internet.
- E-mails.
- Commercial text messages.

What's excluded?
- Fax.
- Voice mail.

Requirements:
- Consent of the recipient.
- Must supply accurate information to identify your firm.
- Recipient must be able to readily unsubscribe.

Consent:
- Express.
- Inferred – keep a note for each recipient to show why you can infer consent if you rely on this form of consent. For example, I hand you my business card with my email address on it. I tell you I want to renovate my kitchen. You sell kitchens. You can infer consent. If you get a business card at a networking function, you do not have inferred consent to sell anything you like to this person. It needs to relate to his/her business.
- Deemed – this relates to published addresses unless the advertisers state they do not want to receive messages.

Conclusion:

Take care. Consult your solicitor if you are in doubt.

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