YEAR END STRATEGIES

THE 2009/2010 TAX GUIDE FOR YOU AND YOUR BUSINESS

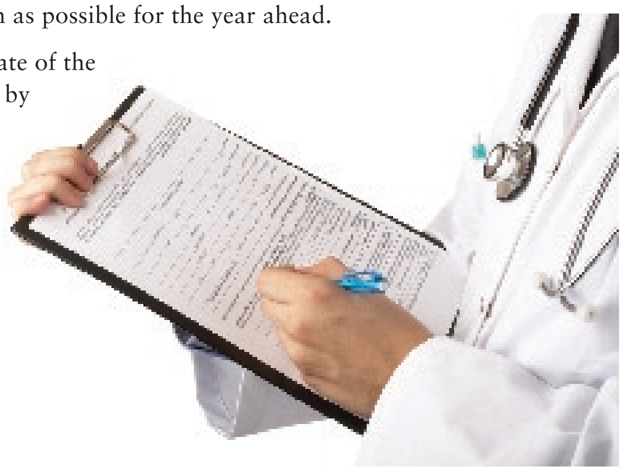
YEAR ROUND PLANNING

GET A YEAR END TAX HEALTH CHECK

The end of the tax or business accounting year is a key time to focus on tax and financial planning. The 2010 tax year ends on 31 March and many New Zealand businesses have adopted this as their annual balance date.

Unlike birthdays, no one likes a surprise around tax time, particularly with the economy still on the mend and many still vulnerable after a difficult year. Now is the time to act and undertake a year end tax health check. It will help determine what action may need to be taken to minimise tax, reduce risk and keep as much cash as possible for the year ahead.

While opinions vary about the likely rate of the economic recovery from the recession, by preparing and updating a forecast of income and outgoings, businesses can identify times when money may be short and plan accordingly.



Many of the ideas outlined in this guide should be reviewed regularly and not held over until the end of the year. In some cases timing is critical so do not delay.

IRD NON-PAYMENT PENALTIES

The IRD has been reinforcing its position with employers not complying with payment obligations.

Non-payment penalties are issued by the IRD to employers who fail to fully pay their employer monthly schedule (EMS) obligations. Penalties of 10 percent apply where non-payment of outstanding amounts continue after the IRD issues a notification.

To ensure employers do not incur non-payment penalties, it is critical they contact the IRD before the due date if they are experiencing difficulty making their EMS payment. If an instalment arrangement is entered into they will not be charged a non-payment penalty.

With end of year just around the corner, employers with outstanding tax obligations would be well advised to take stock of tax obligations. Now is an ideal time to review obligations and future cash flow requirements to ensure that any payment arrangement entered into is sustainable.

IN THIS GUIDE

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CHARTERED ACCOUNTANTS

THE END IS NEAR – TAX YEAR END THAT IS!

In tax, timing is everything. With the end of the year rapidly approaching it is time for businesses to tidy up loose ends before the new tax year begins.

Here are a few things that business owners may need to take into account and act on before the end of the year.

1 .Write off bad debts

In order to claim a deduction for bad debts, the amount must be written off from the accounts receivable ledger before year end. To qualify as a bad debt, there must be no reasonable likelihood that the debt will be recovered. If, after writing off the bad debt, it is recovered, the amount must be treated as taxable income in the year it is received.

2. Prepaid expenses

Some expenses can be prepaid, written off for financial reporting purposes and claimed as a deduction only when paid. Other expenses, howver, can be prepaid and at the same time claimed as a tax deduction (e.g. stationery, magazine subscriptions, rates). Furthermore, others are deductible subject to monetary and time limits (e.g advertising, rent, and consumables).

3. Review private loans

Where a private company provides loans to shareholders, a review of the loan arrangement is necessary. Specific rules apply to private loans, which may have the effect of the loans being deemed as income to individuals.

4. Pay employees within 63 days

Payments to employees (e.g. salaries, bonuses, redundancy, leave) are only deductible up to 31 March 2010 if they are actually paid within 63 days after year end (i.e. 2 June 2010 for a business with a 31 March balance date).

5. Value your trading stock

Businesses that have trading stock will need to value any stock on hand at year end. Most businesses would generally use the cost of the goods. However, if the market value of the stock on hand is lower than cost of the goods, businesses may be able to use that value instead. The value of closing stock does not include GST for businesses registered for GST. The method of calculating closing stock must be consistent each year.

6. Imputation

Companies need to ensure that the company's imputation credit account is in credit at 31 March, to avoid the requirement to pay the debit balance together with a penalty to IRD. Particular attention should be paid to the company's imputation credit account balance to ensure that it does not become overdrawn.

7. Losses elections

2010 loss offset elections or subvention payment elections must be notified to IRD before 31 March 2010, and subvention payments must be paid before 31 March 2010 to be effective. IRD does have discretion to accept late notices but taxpayers should seek advice if they are not sure of the impact on their business.

> **TAX PAYMENTS DUE**
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> *Taxpayers with a 31 March balance date and an extension of time to file their tax returns need to pay their 2009 end-of-year income tax by 7 April 2010.*
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> *Any taxpayer who has difficulty paying by the due date should be encouraged to contact the IRD as soon as possible, preferably before 7 April.*

NEW SECONDARY TAX RATE INTRODUCED

A new, lower secondary tax rate of 12.5 percent will be introduced from 1 April 2010.

Changes to the secondary tax codes are not tax cuts as tax obligations remain the same. The introduction of the lower secondary tax rate simply reduces the chances of a person being over-taxed in the course of the year.

A secondary tax code is the rate that is applied to withhold tax from an individual's employment income that is earned from a second job. Income from a taxpayer's primary job has tax withheld using the progressive income tax rates and thresholds. A secondary tax code reflects the tax rate that individuals face on the last dollar of their total income.

A 12.5% secondary tax code is being introduced to cater for low income taxpayers that have a second job. The new tax code should ensure that excess tax is not withheld on their secondary employment income. It also reduces the likelihood that people with lower income will face tax bills due to having insufficient tax withheld on their secondary income.

Employers will need to ensure that their payroll system can deal with the changed rates before the end of the financial year.

Home is where the tax deduction is

Many people receiving termination payments last year used the fund to start home-based businesses. Now, they are facing the first year of having to claim tax deductions for their home offices.

With so many businesses now being run from home, the IRD are careful to ensure that those claiming tax deductions do so correctly.

UNDERSTAND THE RULES

Many business owners running a small business use an area set aside in the family home for work purposes. If this is the case a claim can be made, provided that:

- that area is used principally for business use (such as an office or storage area), and
- a full record of all expenses claimed are kept.

The responsibility for keeping invoices and records for a home office is the same as for any other business expenses you are claiming. Invoices for these expenses must be retained.

Claims may be made for expenses that relate to the area set aside for business. Taxpayers need to calculate the percentage of the work area, compared to the total floor area of the house. Then the percentage is applied to the total eligible house expenses.

It is highly unlikely that a home office claim can be made where a taxpayer earns passive income such as interest and dividends.

WHAT CAN BE CLAIMED?

Business owners that are conducting their business from their home may be entitled to claim a portion of the following expenses for income tax purposes:

- Rates
- Insurance
- Telephone
- Interest on Mortgage
- Repairs and Maintenance
- Power

The amount of these deductions is generally based upon the percentage of the home area that is used for business purposes, but there are some special circumstances.

Where GST is charged on these home office expenses (i.e. rates, power etc.), a GST claim can be made for the portion of the business expenses, provided that the business is registered for GST.

Telephone

Business owners may claim a deduction for telephone rental if a business or organisation is run from home. If the home is the centre of operations or management for the business, taxpayers may claim a deduction of 50% of the telephone rental.

Identify calls that are business-related. It may be a good idea to get a separate commercial line so that the full cost can be claimed. This also makes it simpler when it comes to proving a claim for both income tax and GST.

Interest

Interest costs can generally be deducted for income tax purposes where the funds are used for a ‘business’ purpose. Taxpayers need to be careful when borrowing money, particularly when purchasing real estate that may be used for business and private use.

Business owners that operate a business from home may claim a proportion of the mortgage interest (not principal) paid during the year using the same method of the business floor area percentage to work out what to claim.

Revolving credit facilities can present difficulties when trying to work out the interest that will be deductible. If this sort of loan is used for both business and private purposes then details should be kept to calculate the non-business component of the interest.

Depreciation

Business owners of home based businesses may claim depreciation on the home. If a depreciation claim is made, any depreciation recovered when the home is sold or the business ceased, must be included the next tax return.

Claims may also be made on the depreciation of capital items such as a computer, office furniture and fittings, or shelving used for business purposes in your home.

Deadline for imputation credits

In 2009 the company tax rate was reduced from 33% to 30%. This has meant that 33% and 30% credits need to be recorded separately over the last year.

The transitional period following the change was intended to allow companies adequate time to fully use imputation credits before they come to an end on 31 March 2010. Any 33% credits that have not been used by 31 March 2010 will be carried forward as ordinary credits and held permanently as excess imputation credits as the maximum credit ratio after 31 March 2010 will be 30:70.

Distributed imputation credits benefit shareholders by reducing personal tax liability – that is unless that liability is already zero.

Those companies which may not have sufficient cash to make a distribution before the end of the transitional period may be able to make a taxable bonus issue to shareholders that use the company’s 33% imputation credits.

Companies who would like to take advantage of the last opportunity to utilise higher imputation credits need to act promptly, but at the same time be aware of some of the risks. These include overdrawing of credits due to overpayment of dividends or taxation refunds.

Those companies with a non standard balance date earlier than 31 March will have even less time to fully utilise the high imputation credits.

New Rules for Charitable Giving

Legislation which introduces a voluntary payroll-giving scheme has been enacted. The scheme allows a tax credit for gifts of money that are paid by way of a deduction from an employee's wages through their employer's payroll.

Employees will now receive an immediate reduction in tax in the form of a tax credit each pay period. Benefits of the scheme include an immediate tax deduction and the elimination of the need for donors to collect and keep receipts to claim the tax relief on gifts of money at the end of the year. The payroll-giving scheme only applies if the recipient organisation, such as a charity or school, is a donee organisation.

The legislation does not define the nature of the arrangements or relationships between employers, employees and donee organisations. It also does not rule how the schemes should be set up in the workplace.

Employers will need to ensure that they:

- deduct the required donation amount from the individual employee's salary or wage.
- calculate the correct tax credits for payroll donations for each donation made.
- record the tax credits for payroll donations for individual employees on the EMS.
- retain records of all tax credits for payroll donations, donation amounts, donee organisations and payment dates.
- remit donations to the donee organisations within the timeframe of the deduction being made from the employee's wage.
- notify the donee organisation that the donation is a result of payroll giving.

The scheme is not a replacement to the current end-of-year donation tax credit claim system. Employees who make donations and do not or are unable to give through a payroll- giving scheme are still eligible to claim tax benefits on their donations through the current end-of- year refund process.

Resident Withholding Tax

From 1 April 2010 RWT (resident withholding tax) rates on interest will be brought into line with recent changes to personal tax rates and the company tax rate.

Businesses that are paying RWT or receiving interest may want to determine whether they will be affected by these changes.

Year End Tips For Property Owners

Document Your Claim
You will need to make sure that you have the receipts to prove your deduction and show why the expense was incurred to derive assessable income.

Interest
Interest can be deducted if borrowed funds have been used to purchase investment property. Be prepared to prove the interest claim where a loan has been used for both investment and private purposes.

Rental Period
Deductions may only be claimed whilst the property is earning income. If a property is vacant or used for private purposes, costs incurred during this time are not deductible, except if the property was unoccupied in order to carry out repairs or improvement.

Below Market Arrangements
If property is rented out to family and friends for less than its true market rental value, property expenses incurred may not be deductible.

Repairs And Maintenance
Review expenditure on repairs. The cost of repairs on investment properties are deductible but care needs to be taken as expenditure that may be considered an improvement may not be treated as a deduction.

Legal Expenses
Legal costs incurred to finance a purchase is deductible. However, legal costs incurred for buying a property are not.

Cleaning And Pest Control
Cleaning both the interior and exterior of a property is deductible, as are costs for pest control.

LAQC Shareholding
Review continuity rules that must be satisfied in order to qualify for LAQC status and ensure IRD is notified of any changes to shareholding.

Capital Items
Capital expenditure incurred to buy or improve the value of a property is not deductible. This not only includes the capital part of a loan repayment, but also legal or accounting fees incurred when purchasing a property.

We Are Here To Help

Make good use of us! This guide is merely a starting point, designed to help you identify areas that might have a significant impact on your tax planning.

Please keep us informed of your plans and consult us early for help in taking advantage of tax-saving opportunities and tax efficient investments.