

NEWSLETTER

March 2003

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YEAR END TAX REMINDERS

For most clients the tax year end is 31 March making now a good time to consider your final tax position for 2003.

Bad Debts

The rules for Bad Debts are precise. You need to be in a position to prove that any bad debts were written off before balance date. We recommend that you review your debtors during the February and March statement runs and physically write off any bad debts immediately. You must have made "reasonable" steps to collect the debts before writing them off and established that the debts were really bad. The write off does not stop you from continuing to chase payment.

Stock or Work in Progress

Most businesses carry some form of Stock or Work in Progress. The tax rules usually require an adjustment for the value of stock or work in progress in your annual accounts. To support this adjustment a stocktake should be completed. Where services are involved, a summary of time records of work in progress should be provided. Please note that

some industries have special rules, for example the calculations for manufacturing operations can be particularly complicated.

Taxpayers with turnover of less than \$1.3 m. in a year can use the value of their opening stock as the value of closing stock providing that their closing stock, based on a reasonable estimate, is worth less than \$5,000.



Holiday Pay/Bonuses

Holiday Pay/Bonuses paid within 63 days of 31 March 2003, i.e. by 2 June 2003, will be deductible in the 2003 income year. The holiday pay entitlement or the decision to pay the bonus must have arisen before balance date.

Fixed Assets

Review your Fixed Asset Schedule. Are there assets listed which are no longer used in your business? Until recently, unless the asset was sold or taken to the dump, taxpayers had to make a written application to the IRD to write off assets which were no longer in use. A law change now permits a write off without reference to the IRD providing you can satisfy three conditions:

- The assets are no longer in use in your business;
- You do not intend to use them in the future; and
- The cost of disposing of the property is more than its disposal value.

Tax to Pay

Many taxpayers will have Provisional Tax due in the last month of the financial year (March) and Terminal Tax in the following month (April). If you are unable to meet either payment please

contact us before the due date. We may be able to alter the level of provisional tax payable or arrange an instalment plan with the IRD. This will help to limit any penalty exposure.

Subvention Payments

Subvention payments to allow the offset of profits and losses between companies with common ownership must be made by 31 March 2003 for the preceding (2002) year.

Shareholders Salaries

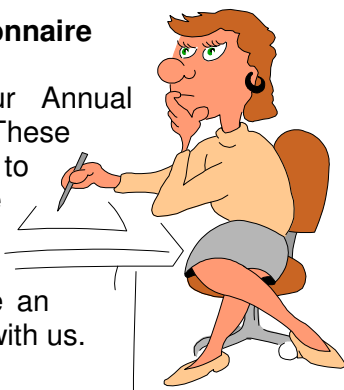
Company minutes must be in place before the year end to authorise payment of remuneration to shareholders and directors. The actual dollars can be quantified after the year end, but the entry in the minute book gives the basis for the company claiming a tax deduction for the salary or directors' fee.

Qualifying Companies

Elections to enter the qualifying company or loss attributing qualifying company regime for the 2004 year need to be in place by 31 March 2003. Likewise the paperwork to go with any decision to exit these regimes for the 2003 year must be with the IRD before the end of March.

Annual Accounting Questionnaire

Review and complete your Annual Accounting Questionnaire. These questionnaires are designed to help us limit the questions we have to ask you at a later date. Once your records are gathered together, make an appointment to review them with us.



MORE TELE TECH DEDUCTIBILITY

Mobile phones - Texting - the Internet - Jetstream - Teletext - PalmTops - Faxes. Feel like technology is taking over your world? It probably is! The challenge for us is to work out how much of the amounts you pay for these services are deductible.

Traditionally businesses operating from private homes are allowed to claim 50% of the telephone line rental and all of the business related tolls.

Phone accounts need to be analysed to determine the business and private portions of the rental.

More and more services are available to home users, (e.g. Call Waiting, Call Minder, Fax Ability, and Internet Access). The question is: What proportion of the charges are deductible? And, when the charges are bundled into the telephone rental cost, how do we isolate the cost of add on services?

The IRD has not issued any updated guidelines on apportionment in the technological age. But we do know they regularly audit these expense areas. For home based businesses our recommendations are:

- Continue to claim the 50% phone line rental and business related tolls.
- Consider the facts of your situation relating to the additional services.

Did you purchase Call Waiting, Call Minder, Call Diversion, or Fax Ability solely for use in your business? If so, the additional rental and service costs should be fully deductible on the basis that there is no private use.

If you purchased these services for your private use and you are also getting a business benefit, you may be entitled to an apportionment. The apportionment basis must be fair, reasonable, and justifiable when the IRD comes to call.

- Where you have an Internet connection at home and home is also your business base, it is almost certain there will be both private and business use of the service. Again, apportionment is required. Do not arbitrarily claim all Internet costs as a business expense. Think about the extent of business and private use and decide on a reasonable apportionment.

- Mobile phones are another problem area. As with Internet usage, you will need to consider the extent to which you have made private calls. Some mobile phone package deals allow you free calls at certain times of day. If you can make all of your private calls in the free call hours, only a proportion of the

package cost representing the phone rental will be non-deductible.

A substantial home office that manages a number of staff and has dedicated business lines and a part-time admin person will have grounds for a bigger deduction.

Messy! We think so. Necessary? Yes. Put together a summary setting out how you will treat each item. Work out the basis of apportionment on estimated hours of access or actual use. Make sure you are confident you can support your decision when the IRD asks: How did you allocate these costs?

LEGISLATION CHANGES

Individual taxpayers

Individual taxpayers will not be required to file IR3 returns for the 2002-03 and subsequent years if they earn small amounts of income (less than \$200 in total) from which no tax has been withheld. Individual taxpayers may still need to obtain personal tax summaries for other reasons, e.g. interest income not correctly taxed, part year earnings.

FBT Prescribed Interest Rate

In our last newsletter we advised that the FBT rate for low-interest, employment related loans had increased to 7.98% with effect from 1 October 2002. The IRD had a re-think after that announcement and in mid-November announced that the FBT rate would be 7.83% from 1 October 2002. Set out below are FBT rates for the 2002-03 year:

1 April 2002	6.70%
1 July 2002	7.50%
1 Oct 2002	7.83%

Holiday Pay

As a general rule, a business can only claim a tax deduction for wage-related provisions when payment is actually made to the employees. This occurs when the provision, e.g. holiday pay, sick pay, or annual leave, is used up.

When businesses change hands the parties involved will agree the basis on which employees transfer. Frequently the new business owner will agree to meet the cost of any leave provisions transferred across. And, the sale price will reflect the liability which the new owner is picking up.

In 2000 the Privy Council considered the NZ Forest Research Institute case. The question was: Who had the right to a tax deduction for transferred employee provisions? The Privy Council decision caused an anomaly - sometimes neither side got a tax deduction.

A recent legislation change will fix the uncertainty surrounding the tax treatment of wage-related provisions. For arm's-length sales, where the purchaser takes over the responsibility for the provisions, the vendor will be allowed a deduction. The purchaser cannot also take a deduction, i.e. no double dipping. If the purchaser finds that the actual leave costs are more than the provision transferred under the agreement, a tax adjustment can be made for the increased cost.

Special rules apply to the sale of businesses between associated persons. Generally the deduction for the leave provisions is available when the purchaser pays out the leave. There is no deduction for the vendor.

If you are involved in pricing the purchase or sale of a business, make sure that you have considered the tax effect of these provisions when doing your sums. And, if you are the new employer you will need to carefully track the draw down of leave and ensure that a tax deduction is only claimed for leave entitlements earned post-acquisition.

WHERE HAS ALL THE MONEY GONE?



Business is like a sponge

Sometimes when a client is presented with a bigger tax bill than expected, we hear: "I can't have made all that profit." And shortly afterwards the statement: "Where has all the money gone, then?" Our objective in writing this article is to reduce the element of surprise. A good business can absorb a surprising amount of cash before you will see some left over- just as a good sponge can absorb water. Here is how it happens.

Increasing your assets

Buying equipment is deceptive. Unless you borrow all the money, you will have had to use some of your profit to pay for the goods. Most people see new plant as an expense. Accountants see it differently. An expense which will benefit the business for some years should be spread accordingly. Only part is an immediate expense, which is referred to as depreciation.

Accrual accounting

Life would be much simpler if we were permitted to account on the basis of cash transactions only. Sales would match the entries on the bank statements. Accrual accounting means bringing in debts as well. Often the money still unpaid to a business at year end will be greater than it was the previous year. This gain is reflected in more profit, but there is no matching cash.

Beware success

It is a paradox the more successful your business the more it can be cash starved. You can understand a failing business not having any money, but why the other extreme?

Imagine a supermarket doubles its sales. If it tried to manage without increasing its stock, its shelves would look bare and lines would run out. Sales would fall. More stock means more shelving and more employees (read wages). Supermarkets run on small profit margins so it will be some time before the profit will be enough to pay for the extra investment.

Managing your cash flow

You would need to sell the business to see the money you have made. Until that time, the best you can do is to understand how to manage the sponge. The smaller it is, the less fluid will be absorbed, so one option is to restrict asset growth. This might mean limiting your business expansion and might not suit you. Successful businesses often require very tight credit control. Debts owing to them are minimised. They also aim to hold as little stock as possible, reordering at the last minute.

If the sponge grows, you can stop it blotting up your money by using someone else's. You can borrow using more hire purchase, bank loans and so on.

How can you see what is happening?

Compare balance sheets, also called Statements of Financial Position.

Look at each asset. If it has increased, the sponge is bigger and has absorbed money. A decrease is the opposite.

Look at the liabilities. To decrease a debt, the business has to get money. A decrease of a liability is thus another way the sponge absorbs your money. You can avoid decreasing your debt by replacing repaid money with new borrowing.

Look at the money you have invested in the business. If it has increased, your money has been absorbed.

Are there any limits?

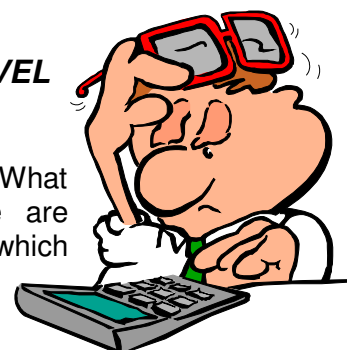
Yes. You can borrow too much. Watch the proportion of your own money in the business. As a rule of thumb, expect it to have at least 40 percent of your own money. Like all rules of thumb, there are plenty of exceptions.

Conclusion

I hope you can now see the answer to the question: "Where has all the money gone?" Please look at the last balance sheet we prepared for you and see how much money your business absorbed. You might be surprised.

OVERSEAS TRAVEL EXPENSES

We are often asked: "What can I claim?" Here are some guidelines, which hopefully will help you. There are three situations:



1 Business is the prime purpose of the trip

The airfares are fully deductible. Apportion accommodation and food on the basis of the number of days engaged in business and the number of days engaged in holiday. You could have a situation where the prime purpose is business, but the holiday element is more than 50 percent. Obviously, the greater the time you spend on holiday and the less on business the more the trip takes on a prime purpose of holiday.

2. The trip is partly business and partly holiday
In this case all the costs should be apportioned on a time basis. Your objective should be to show your claims are fair and reasonable.

3. Prime purpose is holiday
In this case none of the air travel is claimable. Apportion accommodation and food based on the number of days on business compared with the number of days on holiday.

General rule

You have to be prepared to prove your case. While you are away, keep a diary with details of who you visited and approximately what happened.

Most business trips require some preparation. There will usually be telephone calls and letters arranging appointments. IRD might call for all the evidence, so be sure to include this if required. Similarly, when you get back to New Zealand there will be follow up calls, letters etc.

Expenses

You will have all sorts of expenses during the day and it will be hard to keep track of them. You should discipline yourself to record your expenses every evening. If you leave them, you will forget them.

As a cross check, try putting, say, \$50 in one pocket and paying out your expenses only from there. At the end of the day, count the money you have left. The difference is the amount you need to account for. Don't be surprised if it's hard to remember where the money went.

USE OF MONEY INTEREST

The tax threshold for individuals at which Use of Money Interest becomes chargeable has increased to \$35,000 from 1 April 2003. Note the start date. The change is not effective until next year.



TAX TRAPS

Employee or contractor?

IRD publication IR336 sets out the criteria IRD uses for determining whether a person is an employee or in business.

Some people think if they register for GST they can call themselves contractors. Be very careful as this is a trap for employers. Be guided by the publication IR336. It is no defence to say the person working for you is registered for GST. That has nothing to do with whether or not PAYE deductions should have occurred. The employee could also be in trouble. IRD could cancel back-year expense claims and charge Use of Money Interest as employees are not allowed to claim any expenses. Some of the factors the department considers in relation to the "employee" are:

1. Does the employer control the "employee" e.g. the hours of work and when holidays are taken?
2. The risk taken e.g. Use of own equipment (not just small tools) and responsibility for losses.
3. Who provides training?
4. Can that person employ others to do the work?
5. Freedom to do work for others.

ARE YOU PROPERLY PREPARED FOR YEAR END?

Has this been a good income year? If yes, consider:

1. Have you paid sufficient provisional tax to avoid Use of Money Interest, which is charged at 11.93 percent on company/trustee income tax in excess of \$2500 or personal income tax over \$30,000.
2. Have you any bad debts? You must write them off before year end or you cannot claim them this year.
3. Are you planning to update any vehicles? Check their book value. Make your change before balance date only if you expect a loss will result from disposing of an old vehicle
4. For farmers, the Income Equalisation scheme.
5. Disposing of dead stock or you will have to bring into account at cost.
6. Writing off unused equipment. Must dispose of it unless disposal cost is greater than it is worth.
7. Carrying out maintenance early to get the cost into the current year.

8. You can incur some expenditure this year and reap the benefit next such as:
 - Advance payments for travel;
 - Stock which can be classed as consumable aids. If less than \$58,000 it does not need to be included in your stocktake.
 - Stationery is not part of stock.
9. If your company has the family trust as a shareholder, do you need to pay a dividend before year end so you can allocate some income to beneficiaries?
10. Do not pay dividends in advance of declaring them or you could be liable for Fringe Benefit Tax.
11. Family members who are company shareholders can receive salary payments after balance date. Non shareholders must be paid and have tax deducted within 63 days of balance date to claim the cost this year.

ACC's COVERPLUS EXTRA

You are not bound to accept ACC as it is. You may negotiate your own deal by choosing Cover Plus Extra. Here are some of the advantages:

1. By nominating the required amount of weekly compensation, instead of basing insurance on prior-year earnings, you get certainty of income.
2. There is no need to prove loss if you have an accident as ACC has accepted your cover.
3. No reduction of compensation if the business profits do not fall during period of your claim.
4. CoverPlus Extra can start at any time. A credit will be issued for unused levies invoiced.
5. You receive 100 percent compensation until you go back to fulltime work. There is no reduction if you go back part- time.
6. You can nominate incomes for spouses even though profits are split 50:50.
7. From age 40, progressive age-related discounts are available because ACC's commitment to payout reduces each year.
8. The ordinary ACC cover for shareholders of new companies is only about \$13,000 income in the company's first year. Could you survive for the rest of your working life on this income?

INFORMATION FROM THE BANK

We suggest you write to your bank and request the following information be sent to you immediately after your balance date:



1. Details of all interest earned including small amounts IRD does not require them to send out. Business people are still required to include these small amounts in their tax returns.
2. If you are going to need to know the principal outstanding and the interest charged on mortgages for the year get the bank to supply the information early. Often banks do not send out statements unless you ask for them. They let the transactions accumulate until a bank statement is full.