NEWSLETTER

RPL ACCOUNTANTS LTD

NEWSLETTER

Issue 3
August 2014 – October 2014

All information in this newsletter is to the best of the authors' knowledge true and accurate. No liability is assumed by the authors, or publishers, for any losses suffered by any person relying directly or indirectly upon this newsletter. It is recommended that clients should consult a senior representative of the firm before acting upon this information.

INSIDE THIS EDITION

Your tax filing and payment options are changing

From 1 October 2014, cheque payments and returns posted to Inland Revenue must arrive on or before the due date to avoid late payment penalties and interest.

Do you pay Inland Revenue by cheque or make payments at Westpac? If so, you need to be aware of changes happening as from 1 October 2014. Westpac will continue to accept cash or EFTPOS payments over the counter after 1 October 2014 but they'll no longer accept any cheque payments, returns or other documents.

We therefore recommend that because of the inability to know for certain that your return and/or payment will be delivered on time, you consider not only paying direct via your bank but that you also change to filing your returns online too. If you would like assistance with this matter please give us a call

2014 Budget

Over recent years there has been a sense of déjà vu through the Budget cycle where we have seen a pattern of minor change and tweaks, with a steady as she goes approach. The focus has remained on maintaining a stable environment and steady economic growth.

Several tax changes were announced. The Budget included proposals to change the tax treatment of certain research and development (R&D) costs. The Government estimates these R&D related initiatives will return over $58 million to eligible companies over the next four years. In particular, capitalised development expenditure (incurred on or after 7 November 2013) that relates to a patent will be depreciable (where the current tax treatment limits the depreciation to the cost of applying for the patent itself).

Also, a one-off deduction for capitalised expenditure on intangible property that is written off for accounting purposes will be allowed.

A further significant change in relation to R&D is that businesses will be allowed to "cash-out" an amount of their tax losses arising from qualifying R&D expenditure (instead of carrying them forward).

In the area of social assistance, changes have been targeted at low and middle income families with new born babies. In particular, the Budget sets out that eligible families receiving parental tax credits (i.e. those not on a benefit and not eligible for paid parental leave) will receive an increased tax credit (up to a maximum of $220 per week) for longer periods of time (out to 10 weeks from the current 8 weeks). As a result, over 1,200 additional lower-income families are expected to claim the parental tax credit because it will pay them more than they would otherwise receive from paid parental leave. There will also be changes to the abatement criteria to better target families in need.

Paid parental leave will be extended by four weeks. This will be implemented with a two week extension from 1 April 2015, and a further two weeks from 1 April 2016. The eligibility criteria for this will also be widened to include caregivers, and people who have recently changed jobs.

The Budget also included the abolishment of cheque duty from 1 July 2014. Cheque duty was acknowledged as an outdated tax due to changes in the way we transact. The tax previously raised $17 million in revenue (in 1991/1992) but had declined to just $4 million.

Other changes include reductions in ACC levies and freezing the Student Loan repayment threshold at the current level of $19,084. In addition, extra funding was allocated to the IRD to follow up on unfiled tax returns. It is estimated that this extra funding will generate a gross increase in Crown revenue of $297.5 million over the next five years.

Motor vehicle options

Although the tax rules around the private use of motor vehicles have been stable for some years now, other variables can change, such as a person's circumstances. This makes it worthwhile to regularly revisit how vehicles are accounted for to make sure the most efficient outcome is being achieved.

Most small businesses operate through companies and this lends itself toward owning a vehicle in the company and paying fringe benefit tax (FBT) for non-business use. For shareholder employees, a variation of this is to charge the value of the vehicle benefit to the shareholder's current account, which arguably eliminates the need to account for the private use of the vehicle for FBT purposes.

In the first couple of years of a vehicle's ownership, the FBT route is typically the best option economically. This is because the tax benefit of being able to claim depreciation, FBT and the running costs, should outweigh the FBT cost itself.

While within the FBT net, it is important to ensure opportunities to minimise private use are taken advantage of. For example, if an employee does not need to have a vehicle available for their private use 24/7 it may be possible to wholly or partially exclude it. The most common way of doing so is for the vehicle to qualify as a "work related vehicle". If applicable, home to work and other incidental travel is not treated as private use. To qualify, the vehicle needs to be sign-written, not principally designed to carry passengers, and there be a condition of employment that the employee takes the vehicle home. The question of whether a vehicle has been principally designed to carry passengers or not, has been before the courts in the past. Basically, it is accepted practice that a double cab ute can qualify because they are not "mainly" designed to carry passengers. However, vehicles that are more in the nature of standard passenger carrying vehicles, such as sedans will not qualify, unless they are modified (such as by removing the back seats). Once a vehicle qualifies, appropriate restriction letters can be put in place and the FBT liability reduces.

Once into the third year of ownership, the cost of paying FBT tends to outweigh the benefit of the various deductions and therefore other options should be examined. For example, the vehicle could be sold out of the company to the user (potentially triggering a deductible loss on sale) and instead a tax free reimbursement approach could be taken. This can involve more administrative work because a record of actual travel and expenditure needs to be kept. However, this can be simplified through the use of a three month logbook and mileage rates. The mileage, as per the logbook, can be multiplied against a mileage rate to arrive at an estimate of the work related travel costs.

The current IRD mileage rate for employees is 77 cents per kilometre. Care needs to be taken though as reimbursements for high business use (in excess of 5,000km) can add up and there is a risk of a taxable benefit arising. However, it is possible to calculate your own rate based on your own specific circumstances. As long as the estimate is reasonable, i.e. broadly equates to actual costs, a mileage rate can be used regardless of the amount of business travel. Given a reimbursement of this nature is non-taxable to the employee and deductible to the employer there is a positive net benefit.

Debt vs Equity

All businesses need some degree of funding in order to achieve long term operating objectives. One of the biggest decisions for a small business owner is whether to fund these long-term financial requirements through debt, equity, or a combination of both.

There are advantages and disadvantages to both forms of funding that should be considered when determining the optimal funding structure for a business.

Equity
One of the main sources of funding for a business is through equity. Equity funding can be raised in a number of ways, such as investment from the owners of the business, investment from family and friends, angel investors, venture capital investors, corporate investors or institutional investors.

Equity funding has several benefits. For example, the amount invested is not redeemable, there are no fixed repayment obligations and, profits can be maximised as there is no obligation to pay interest (which reduces the level of financial stress on cash flow). There is also no obligation for the business to pay dividends, which can be important during the start-up phase of a business where cash can be limited.

On the downside, the cost of equity funding is more expensive than debt funding. This is due to equity presenting a higher risk to investors because in the event of financial difficulty debt is repaid before equity. This results in a higher expected rate of return. Further to this, if dividend payments are made, they are not deductible for tax purposes.

Equity holders are also the last to receive repayment in the event of bankruptcy (hence the higher returns required).

Long-Term Debt
Many businesses use some form of debt funding with commitment to payments of interest and/or principal at regular intervals. The main type of long term debt funding used by businesses is loans, either from a bank or other private investors. Larger businesses may also issue bonds.

The main advantage of debt funding is that it is generally a cheaper form of funding than equity and the interest payments are tax deductible.

The downside of debt financing is that interest payments must be made on a regular basis, which can put financial pressure on a business and impact on profitability. The regular outflow of cash also means less cash is available for other projects. In addition, if the business has too much debt, it may be viewed as high risk, and it may be difficult to obtain equity funding if required.

Most businesses opt for a mix of both debt and equity in order to try and reduce the downside of each type of funding. In some cases this can provide other advantages, for example it is possible to shift tax deductions for interest from a company to its shareholders by borrowing to acquire shares. Ultimately, the right mix will come down to the size of the business, appetite for risk, and the stage the business is at in its life cycle.

Snippets

Tax Bill enacted

The Taxation (Annual Rates, Employee Allowance, and Remedial Matters) Bill was enacted on 30 June 2014. One of the notable changes included in this Act included amendments to clarify the tax treatment of employer provided accommodation, accommodation allowances and other reimbursing payments made to employees. Most of these changes will come into effect on 1 April 2015.

The IRD has issued a special report that sets out information on the new rules regarding the changes to employee related payments. To view this report please use the following URL: http://taxpolicy.ird.govt.nz/publications/2014-sr-employee allowances/overview .

The Act also deals with distortions arising from the treatment of black hole expenditure, strengthens the thin capitalisation rules, reforms the income tax treatment of land related lease payments, and changes the tax treatment of receipts for easements.

The New Zealand economy is growing

Here are 5 practical ways for you to ensure your business is ready to make the most of this market growth.

1) Know your customers. The best way to know who your potential customers are, or in marketing speak, your target audience, is to know your current customers: their socio/economic demographics, what they think, their opinions, what they read and where (what medium) they read it. Where are they? What do they know about your organisation, the products and services it provides? What are their perceptions of your organisation and their buying experience when they last bought from your organisation? If your customers are mainly businesses, what depth of knowledge do you have about their business?
2) Understand the life-long value of a customer to your business. Look at adding value to your product or service offerings to cause customers to remember your organisation and come back to buy from you and/or tell other people about your service.
3) Service quality and levels: How do your customers want to be treated, what levels of service should your organisation provide? What scripts do your staff use when they answer an enquiry from a potential customer and how can these be improved to increase the rate of conversion from enquiry to sale? Make it easy for customers to do business with you and make it a pleasantly surprising experience. That may mean re-structuring your customer service area to focus on providing the appropriate service.
4) Test your advertising. Change the wording, font size/boldness, the headlines, the message emphasis and the medium that you are using (print, radio, internet), but test changes in a way that will allow you to analyse your enquiry and sales results, to ensure that the changes you finally make get the most “bang for your buck”.
5) Be different from your competitors. Add value, have a different range of products/service offerings, and create a unique experience when they enquire and/or buy from your organisation.

IRD to share information with police

Currently, most information provided to the IRD is confidential and is not able to be shared with third parties, including other Government departments. This means that in the event the IRD investigates a taxpayer and uncovers evidence of illegal activities under current law this information cannot be shared with the police.

Under recently enacted legislation, the IRD has entered into an information sharing agreement with the police that came into effect from August this year. The IRD and the police will be able to share personal information for the prevention, detection, investigation of, or use as evidence of, a serious crime. A serious offence is defined as a crime punishable by more than four years in jail, such as burglary and money laundering

The IRD haven't entered into this agreement lightly; as the concepts of confidentiality and "tax secrecy" underpin the public perception of the integrity of the tax system. As a result, information can only be shared when it relates to 'serious crime', consequently the police will not have access to the vast majority of information stored by the IRD.

According to the Police Minister, Hon. Anne Tolley, the agreement will help the police tackle drug manufacturing and distribution, money laundering and organised crime. The role of tax authorities in the prosecution of serious criminals is not without precedent. Possibly the most well-known case is that of Al Capone, the infamous Chicago mobster. Although Capone's exploits were widely known, the police were never able to find sufficient evidence to convict him. Capone was eventually jailed for tax evasion, following an investigation by the US Internal Revenue Service.

It's a little known fact, but the proceeds from illegal activities are generally required to be returned as income and subject to tax. There may not be a large number of drug dealers and money launderers that comply with their income tax obligations by dutifully including their ill-gotten gains as "other income" in their tax returns. However, during the process of an investigation, or as a result of information received from other taxpayers (or the criminal themselves), the IRD will from time to time possess information that will be useful to the police.

The agreement does not mean the IRD will broaden its crime fighting efforts beyond that of tax evasion, nor does it mean that everyone's financial information is accessible by the police. But it may result in a few more 'bad guys' having to face the music.

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