To qualify for the tax credit, taxpayers must satisfy what is referred to as the general eligibility criteria, which are:

- Their business must be carried on in New Zealand
- Eligible expenses must be in excess of $20,000 in the financial year
- The taxpayer making the claim must bear the risk of the project, control and own the results.
- The research and development activities must be conducted predominately in New Zealand.

Core research and development activities are described as a systematic, investigative and experimental activity, that has scientific or technological uncertainty and is carried on for the purposes of gaining new knowledge, creating or improving products, processes or services. To qualify as research and development expenditure there has to be risk and uncertainty about the outcome of a particular investigation.

Eligible expenditure as defined, includes:

- Employee remuneration
- Costs of staff training and recruitment
- Depreciation of tangible assets used primarily in conducting research and development
- Payments to other organisations conducting research and development on behalf of the claimant
- An appropriate share of overhead costs

We note that there are a number of costs that are excluded from the definition of eligible expenditure including interest relating to borrowed funds for undertaking the research and development and the acquisition of core technology or intangible assets such as trade marks and patents.

The changes announced in the May budget are still progressing through Parliament and at this stage, the Tax Bill has not yet been enacted into legislation. Unfortunately the research and development credit guidelines have not been released so there is still significant doubt as to precisely who will qualify for the tax credit. We will provide an update on this subject as more substantive information comes to hand.

KiwiSaver Risks

KiwiSaver has its good and bad aspects. In this section we outline some of the risks.

- Your KiwiSaver contributions are not protected against creditors. If you go bankrupt you will lose your KiwiSaver contributions.
- Some KiwiSaver schemes might fail. The Government does not insure you against this. The economy, with its full employment, will not always be as good as it is today.
- KiwiSaver providers might sell their business, which could lead to changes in investment strategies.
- Don't invest and forget.
- Expect many new governments during the years you are in the scheme, and hence many rule changes.
- Fees might not stay at the same level as they are today. The Government Actuary controls KiwiSaver fees, but they might increase if the cost of running the schemes proves higher than anticipated.
- Staff with good skills are sought-after and move on. Keep an eye on your fund managers.
- You do not join the scheme and the future government abolishes or severely limits National Superannuation. You wish, as a result you had joined.
- You do not join the scheme and could have collected the subsidies, when you had the chance and then it becomes compulsory and the subsidies are abolished. You wish you had joined earlier.

KiwiSaver Administration

When a new employee joins your staff, you must:

- Give them a KiwiSaver kit within seven days;
- Deduct 4% KiwiSaver contributions from the very first pay packet.
- Keep records of KiwiSaver deductions for at least seven years after the employee has left your employment.

Employees can only opt out by completing a KS10 opt out form online. If the employee opts out, IRD will refund all contributions.

Trap: Any new employee providing you with an opt out form within the first fortnight of employment has not opted out. Opt out must be between the beginning of the third week of employment and the end of the eighth week. If you receive a late application to opt out, send it to the IRD and do not act on it.

TAX CALENDAR

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 dates)

Disclaimer
The information contained within this newsletter is of a general nature only and readers are advised that even minor differences in factual circumstances may result in significantly different tax consequences. This newsletter is not intended to replace specific tax advice. As always, specific advice should be obtained for the particular factual circumstances. We accept no liability for persons relying upon information contained within this newsletter.

kga
keith goodall & associates ltd
chartered accountants

PO Box 37 223, Parnell, Auckland
Level 2, 123 Carlton Gore Road
Newmarket, Auckland

E-mail: admin@kgal.co.nz
Telephone: 09 921-4630
Facsimile 09 379-5499

CLIENT NEWSTALK

December 2007

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GST and Provisional Tax

From 1 April 2008, 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

$7,000, the ratio would be $7,000/200,000 = 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 = $1,050. 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, provisional tax will be paid 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, as provisional tax payments will be better spread during the year.
- The really big benefit though is that use of the GST ratio approach overrides the liability for use of Money Interest (UOMI) if the 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 rules as they have to attribute the company income to the shareholders because more than 80% of the income is derived 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 the 2009 financial year. i.e. before 31 March 2008. Also GST must be paid at least six times a year.
- If your business has an annual tax liability (called Residual Income Tax) of more than $150,000, you are not allowed to use the GST ratio. Shareholder

salaries can be deducted before arriving at the taxable profit for a company.

- If all company profits are paid to shareholders but UOMI could become an issue, you could make your company a provisional taxpayer and register for the GST ratio. You would need to leave a profit of at least $7,576 in your company.
- Provisional tax is payable on the basis of all sales, including asset sales. It is possible to adjust for asset sales if the amount is large.
- We will be reviewing the tax status of all client companies and forming a preliminary view as to whether it will be beneficial to enter this regime.

Taxrates 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 in either of the last 2 years. Since PIEs came into existence only on 1 October 2007, PIE income will not be included for the year ending on 31 March 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 you income is above these thresholds your rate is 33%.

Joint Investment
If you invest jointly, split the investments between you, so you can each 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 as the beneficiaries will be paying tax at 19.5% on the distribution they receive.

Company Tax Rate Changes

THE tax rates for companies will be reduced to 30% from the start of the 2009 tax year (for 31 March balance dates). This will be 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%. These will be available for use until 31 March 2010. After that, all tax credits attaching to dividends will be at 30%. There are therefore some tax planning issues involved which will need to be decided over the next three years.

If a family trust owns the shares, the dividends should be paid sooner rather than later, unless the tax rate for trusts is to be reduced. If the shares are owned personally, it could be wise to wait for the next 2008 Budget to see if personal income tax rates are reduced.

Unsolicited Electronic Messages (spam)

The following is a brief summary 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. Take legal advice if in doubt.

We wish all our clients and readers a happy holiday season

Insolvency Act Changes

Recently there were some significant amendments passed by government to the Insolvency Act 2006 that have introduced an alternative to bankruptcy in certain situations. This process is referred to as the No Asset Procedure (NAP).

Currently, if an individual is bankrupted, they cannot get discharged from bankruptcy for 3 years. The view that has been expressed, that inturn has given rise to the No Asset Procedure regime is as a consequence of a 3 year period for a person to remain in bankruptcy is inappropriate and punitive for debtors that have not been in business, have no significant assets and do not have substantial debt. The NAP will allow such debtors to essentially clear the slate, and be relieved from their obligations after a period of only 12 Months.

For a person to elect the NAP the debtor must have:
- No realisable assets
- Not previously been in an NAP
- Not previously bankrupt
- Have no more than $40,000 debt, excluding student loan and fines
- No means of repaying their debt

Someone qualifying for the NAP will not have any assets, and consequently there is no need for vesting in those assets in the Official Assignee under the Insolvency Act. NAP debtors are not permitted to obtain credit either by a loan or jointly in excess of $1,000 without first disclosing their NAP status to their perspective lender.

Clearly this is a process that can potentially be abused and there are provisions in the Act whereby the NAP can be determined by the Official Assignee if it becomes apparent that the debtor should not have been admitted to the NAP regime in the first place i.e. the debtor has misled the Official Assignee about their affairs by concealing assets, or whether debtors circumstances have changed to the extent that would enable them to pay a part or all of their outstanding debts.

Upon termination of the NAP, all of the debtor's debts become enforceable and the usual legal process to collect debts can be initiated.

It remains to be seen how many debtors will avail themselves of this opportunity and it is not hard to visualise that people with limited income and no assets can run up debts on credit card or with other suppliers and then simply enter this regime and after one year, be freed of those debt obligations. Our message for clients is to be even more vigilant before extending credit on an unsecured basis to debtors who have limited assets and limited income.

Quote of the Month

We all live under the same sky, but we don't all have the same horizon.

Little Snippets

- 200,013 joined KiwiSaver in its first 3 months of operation, which was twice the number that Treasury expected.
- The proposed changes to the associated persons rules were expected to come into place on 1 April 2009. As presently drafted, this will mean that property developers will pay tax on all property gains regardless of whether the property was acquired for investment or development. As most property developers are more likely to be National Party voters, is this a sign of the times i.e. a targeted capital gains tax on non Labour voters?
- To what extent does New Zealand's immigration policy reflect a desire of current government to see more potential Labour voters coming to New Zealand, rather than National Party voters.
- Tax legislation has been introduced to deal with the question of relocation allowances and is retrospective for 4 years. If you have paid relocation allowances within the past 4 years, please contact us for further details.
- If you are involved with a charity, ensure that you arrange to have it registered with the Charities Commission. Apparently the registration rate is very slow and if charities are not registered by 1 July 2008, they will potentially lose their tax exemption status.
- Remember that taxpayers are permitted to switch the basis for calculating the FBT on a car available for private use from original cost to the tax book value once the company has owned the vehicle for 5 years. This potentially has a significant impact on the amount of FBT payable.

Research and Development Tax Credits

There was a significant tax change announced in the 2007 budget relating to research and development. This announcement was in connection with creation of a research development tax credit with the proposal giving rise to a credit of 15% of qualifying expenditure. The budget announcement noted that legislation would be in place to give effect to the research development tax credit from 1 April 2008.

The benefit of a tax credit is it allows the taxpayer to receive the 15% benefit in cash if the trading entity is in a tax loss situation. For taxpayers who otherwise have tax to pay, the credit will offset and reduce the tax liability.