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CLIENT NEWSTALK

May/June 2010

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Tax Calendar

The 2010 Budget was delivered on Thursday 20 May with different opinions around whether the Government did enough to reform the tax structure. Mr English has maintained however that tax neutrality is fundamental given the current economic situation.

A summary of the major changes announced on Thursday are:

- The GST rate will increase from 12.5% to 15% on 1 October 2010. Clients will need to be prepared and plan the necessary changes to accounting systems and processes ahead of time.
- Personal income tax rates are reduced also with effect from 1 October 2010, as follows:

Income	Current	New
0-14,000	12.5%	10.5%
14,001-48,000	21%	17.5%
48,001-70,000	33%	30%
70,001+	38%	33%

- Company taxation will decrease from 30% to 28% from 2011/12 year. PIE's, superannuation funds, unit trust, group investment funds and life insurance policies income will be subject to the same rate.
- Qualifying Companies; From 1 April 2011, QC and LAQC's will be treated as "flow through" entities similar to limited partnerships. In effect the profits will now be treated the same as the losses and be attributed to shareholders.
- Depreciation; the 20% depreciation loading on new assets purchased after the 2010 budget has been removed. Zero depreciation rate from 1 April 2011 for buildings with expected lives of 50 years or more regardless of date of purchase.

Other budget changes include tightening of Working for Families tax credits and International taxation. The IRD will also receive a funding boost of \$119.3 million over 4 years starting 2010/11, towards audit and compliance activities around debt collection, the hidden economy and property transactions.

Budget 2010

In recent years the budget has tended to focus on matters of economic policy rather than with comprehensive and specific change to the tax system. Many will remember the days when key changes to the tax system were announced in the budget night speech and consequently public interest in and awareness of the budget itself were probably at a greater level than they are today. The Tax Working Capital Group proposed a number of tax reform options in its report to the Government titled "A Tax System for New Zealand's Future" and this ensured a great deal of interest in the 2010 Budget.

Associated Persons

Substantial reform of the "associated persons" definition has been brought into play as a consequence of changes to the Income Tax Act

The new definition generally applies from the start of the 2010 - 2011 tax year i.e. 1 April 2010. However the changes relating to land transactions generally apply in respect of land acquired on or after 6 October 2009 or where relevant improvements to land are begun on or after that date.

The definitions now cover a very broad range of relationships for most purposes, particularly those between trustees, settlors and beneficiaries.

The new definition of "associated persons" is extremely wide. Under the old rules it was possible to break the associated persons rules by using a trust. Under the new rules, if the settlors of the trust are the same or the same person has the power of appointment, the separate trust will be associated and "tainting" can occur. The difficulty is that a property investor may enter into a property transaction believing it is free of any tax consequences on a sale. However such a person could inadvertently find themselves in the tax net because they are associated with someone who "taints" the transaction.

The associated party rules for tax purposes have always been difficult and complicated and these changes only serve to make them very complicated. It is critical in our opinion that you take advice with respect to all property transactions that you are planning to enter into before any binding commitments are made.

Assets Transferred To Close Relatives

The Tax Bill enacted on 6 October 2009 now includes a change to the tax treatment of assets transferred to close relatives. All property that is transferred on death that is to be distributed to close relatives is treated as a transfer at market value. There will therefore be a depreciation recovery on death and an income tax liability may arise for the Estate. Pending the estate being wound up it continues to depreciate the asset at its market value for the term of the administration of the Estate. The property is then transferred to the close relative beneficiary at the Estate's tax written down value (that is market value less any depreciation expense during the period of administration).

Distributing Trust Income

With effect from the year ending 31 March 2010, trustees can defer allocating income to beneficiaries for a longer period of time. Previously, trustees had six months from the end of an income year to allocate income. This has now been extended. Trustees now have until the later of the end of the six month period or the period within which to file an income tax return in which income is allocated as beneficiary income.

That means that trustees can potentially allocate beneficiary income up to the following 31 March. Given the current differential tax rates between trustees and beneficiaries, this may be of benefit.

There is however a possible difficulty as some trust deeds provide that income not allocated within six months of year end is automatically allocated to capital. In this case no benefit will arise from the application of differential tax rates.

We will review client trust deeds as we complete the 2010 financial statements to ensure any distributions comply with provisions in the deed.

This tax change only applies to income earning trusts. If a family trust simply holds the home and/or other passive non-income earning assets, this tax change will have no effect. In this case no benefit will arise from the application of differential tax rates.

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Net Migrant Inflow

New Zealand's net migrant inflow continued its rapid increase in January, when arrivals fell slightly but departures fell even more. In the year to January the net gain was 22,588.

Arrivals from Australia jumped 16% in January to 1875, and by 14.6% for the year to 15,051. If you read a newspaper story saying the exodus has resumed, don't believe it: Departures to Australia have been slashed down 30% for the month to 4003, and down 36% for the year, from just over 48,500 to 31,070. There was still a net outflow to Australia of 2128 for the month and 16,019 for the year, and this is down 19,362 from the previous year.

He net gain from the UK for the year was up 12.4% to 8868. From Asia, the net inflow from China rose 46% to 3919, the net inflow from India rose 11.5% to 5895, and the net inflow from the Philippines fell 41% to 2187.

The number of short-term overseas visitors arriving in January rose by 5.2% to just under 257,000, and the arrivals figure was up by 22,000 (0.9%) to 2.47 million.

FBT & Vehicles

The question of when you can use your company vehicle for private running is a vexed one.

In simple terms the answer is yes but you must pay Fringe Benefit Tax (FBT) regardless of how little you use the vehicle. You can restrict private use to certain days of the week and reduce FBT and if so it is essential that this is in writing.

Some clients are of the view that a van or other work-related type vehicle can be used for private running if it has sign writing on it. This is only correct if the use is incidental to travel on business. For example, you stop on route to buy groceries. This relaxation of the rules does not apply to cars.

An employer can require a work-related vehicle to be taken home by an employee, but this doesn't confer any right to use it for private running, apart from travelling between home and back to work. Again, this doesn't apply to cars i.e. if they go home, FBT applies.

If you own the business and want to restrict your private use, we recommend a directors' minute be signed approving the arrangement. If your spouse is also a director, he/she should sign the letter authorising the partial use, rather than you authorising it for yourself.

Tax Intermediaries

In recent years there have been two organisations approved by Inland Revenue as tax intermediaries. What this means is that taxpayers can "buy" tax and pay for it up to a year later (at interest rates currently less than 6 per cent per annum) or alternatively if provisional tax has been underpaid it is possible to buy "old" tax thereby reducing use of money interest and penalties if they apply.

If any clients wish to avail themselves of this service please contact us to discuss the details.

Charitable Donations

For a company to claim charitable donations as a deduction for tax purposes there has to be sufficient taxable profit in that year to cover the donations. The total donations made by a company are tax deductible. However if the level of donations made are such that the company incurs a tax loss the loss will not be tax deductible to the extent it arose as a consequence of donations made.

Company Failures

An Auckland insolvency practice has recently conducted a survey of 150 insolvencies they have recently undertaken. What they found was that the competence of the directors was a factor in 40% of business failures and was the only reason in nearly 30 per cent of failures. Anecdotal rumours such as lack of capital, dubious business practices or faltering economy were also primary drivers.

One of the most misquoted bits of information about insolvency is that 80 per cent of the businesses fail in the first five years. This may well be correct as if a major factor is the competence of directors they are likely to fail in the earlier years of a business operation rather than in later years.

LAQC Test Case

IRD has recently won a case brought against a Loss Attributing Qualifying Company ("LAQC") that was heard before the Taxation Review Authority. In this case the LAQC had been set up to make a private home tax deductible so the owner rented the home from the LAQC and offset the resulting losses against personal income. In doing so the owner had claimed \$71,000 in losses over a four year period and offset them against personal income. The IRD were of the view that the arrangement constituted tax avoidance. The practice, in this case, was held by the TRA to be tax avoidance and as the owner was on a 39% tax rate the avoided tax was more than \$25,000. The owner was thus liable to this amount plus interest although fortunately, for the taxpayer, no penalties were imposed.

An LAQC set up for property rented to third parties is not affected by this decision. The IRD still accept that beach houses actively marketed for rental that result in losses that are eligible for offset. In an earlier newsletter we did set out details of the rules that IRD apply in these cases.

Little Snippets

- Retirement Villages: The Retirement Commission has produced an excellent publication titled "Thinking of Living in a Retirement Village?" If any clients are looking at this for either themselves or their parents this publication is an invaluable guide as many retirement villages have quite complex legal and financial structures and it pays to do the research.
- Use of Money Interest: Use of money interest rate for unpaid tax is now at 8.91% while the rate for overpaid tax is a mere 1.82%.

Voidable Transaction

There is much confusion regarding the rules in this area. In the current economic environment where the level of insolvencies is rising a number of clients are finding themselves on the receiving end of claims from liquidators seeking refunds of monies previously paid for goods or services supplied.

A voidable transaction is one where a liquidator is has the power to unwind payments if he considers that such a payment has given one creditor a better result than could be achieved on a liquidation,

For a transaction to count as voidable the liquidator must establish that the transaction enables one party to receive more towards payment of a debt owed by the company than the party would receive, or be likely to receive, in the company's liquidation.

The previous test was around the question as to whether the payment was made in the ordinary course of business and this is the concept debtors have lived with for many years. This test was always controversial by virtue of the diametrically opposed views invariably held by the liquidator and the debtor being the recipient.

The Companies Amendment Act 2006 introduced the "running account exception" rule to replace the "ordinary course of business" test.

How this works is best illustrated by an example. If in the six months (the normal period a liquidator will challenge) before a customer goes into liquidation you provide goods or services worth \$x and you receive more than \$x as some of the monies received related to goods or services supplied more than six months ago the liquidator will only challenge the monies received in excess of \$x.

If a supplier is aware that a customer has solvency problems and seeks to take advantage of that by, for example, continuing to supply on a COD basis conditional on a series of instalment payments to clear the overdue debt there is a real risk that a liquidator may challenge this and claim a voidable preference. We can provide advice to any clients finding themselves in this situation.

Quote of the Month

"Conformity is the jailer of freedom and the enemy of growth" John F Kennedy.

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.

TAX CALENDAR

May 7

3rd instalment 2010 Provisional Tax
(March balance date)
GST for March 2010

May 28

1st instalment 2010
Provisional Tax
(December balance date)
GST for April 2010

May 31

FBT 4th quarter 2010
(January-March 2010)

June 28

April-May 2010 GST return
May 2010 GST return

July 20

April June 1st quarter FBT return

July 28

June 2010 GST return
3rd instalment of 2010 provisional tax
(June balance date)