

# End of Year Tax Checklist

It's that time of the year again when you'll need to start gathering together your accounting and tax information for the year ended 31 March 2007. Set out below is a list of items that will assist you with this process, and remind you of some of your tax obligations.

## Deductions

Deductible expenses may be claimed in the year in which they are incurred, even though payment may be made in the following year. Following are some special expenses which are either deductible in full or in part when they are incurred, but are related to the next income year.

The following expenses have no restrictions on the amount deductible:

- Stationery, postage and courier costs;
- Subscriptions to newspapers, journals, and other periodicals;
- Rates;
- Road user charges; and
- Audit and accounting fees.

## Advertising

Prepaid amount less than 6 months and under \$12,000.

## Bad debts

To be deductible, bad debts **must** be written off **during** the income year. A mere provision or reserve is not deductible.

## Consumable aids

Amount on hand under \$58,000.

## Depreciation

- Taxpayers have the option of depreciating fixed assets on either a diminishing value or straight-line basis.
- Fixed assets can only be depreciated from the month of purchase, eg plant and machinery purchased on 25 March 2007 is depreciated for one month.
- Items costing up to \$500 (net of GST) may be written off in the year of purchase if certain criteria are met.

## Disability/loss of profits insurance

Premiums are deductible in full where the taxpayers are in business on their own account, or are employees.

## Discount reserve

A deduction for a discount reserve, such as a prompt payment discount reserve, is allowed if debtors are entitled to this discount.

In the first year, a deduction of 2.5% of the debtors' amount is allowed, and in subsequent years adjustments are made which maintain the discount level at 2.5% of the debtors' amount. If a higher discount is generally given, this could be used instead of the 2.5%.

## Equipment service contracts or warranties

The full amount is deductible, provided it forms part of the consideration for the assets.

## Holiday pay

The amount accrued at balance date is deductible, if paid within 63 days of the balance date.

## Prepaid insurance premiums

Where the total insurance expense in the year does not exceed \$12,000, a 12-month prepayment is claimable.

## Lease or bailment of livestock

Prepaid amount less than 6 months and under \$23,000.

## Other services

Prepaid amount less than 6 months and under \$12,000.

## Rent for land and buildings

Prepaid amount less than 6 months and under \$23,000.

## Repairs and maintenance

Generally no deductions are allowed for a repairs and maintenance reserve, except for the periodic overhaul of business aircraft and the maintenance obligations of a construction firm under its building contracts.

## Royalties

Royalties accrued to balance date are fully deductible.

**Service or maintenance contracts**

A prepayment of 3 months' expenses is deductible, provided the total expense on the contract does not exceed \$23,000 in the income year.

**Subscriptions for trade professional associations**

A prepayment of 12 months is deductible provided the total amount for that association in the year does not exceed \$6,000.

**Telephone and other communication equipment expenses**

A prepayment of 2 months is deductible.

**Trading stock valuation**

Don't forget to do a stocktake!

New stock and work-in-progress valuation rules were introduced from the 1998-99 income year, and have applied since.

The valuation methods differ depending on whether or not you are a 'small taxpayer'. Small taxpayers are those who, together with their associates, have an annual turnover of \$3m or less.

If the turnover is less than \$1.3m and a reasonable estimate of the true value of stock is made to be under \$5000, then a physical stockcount at year-end is not required and the opening stock value may be used.

Please contact us to establish the valuation rules that apply to your situation.

**Travel and accommodation expenses**

Prepaid amount less than 6 months and under \$12,000.

**Income**

Review credit notes in the months following balance date for any credits which are able to be taken back into the previous financial year.

**Records required**

- Cash books/bank statements;
- Cheque butts, deposit butts;
- Documents relating to the purchase of fixed assets;
- Hire purchase/lease agreements;
- Solicitors' settlement statements;
- GST returns and workpapers;
- Wages reconciliation;
- Term loan statements;
- FBT return copies;

- Log books;
- Stock sheets;
- Debtors and Creditors lists.

**Penalties regime**

There is a mandatory 'shortfall' penalties regime in place – the penalties range from 20-150%. These penalties cannot be remitted.

Examples of where automatic penalties will be applied include when:

- Motor vehicle logbooks are not kept. (If you are self-employed, a logbook must be kept for a 3-month period every 3 years). Please check that your work-related vehicles still meet the criteria, otherwise fringe benefit tax may be applicable.
- Stocksheets are not kept, or a stocktake is not physically taken.
- Bad debts are not physically written off before 31 March 2007.
- Withholding tax (usually 20%) is not deducted from subcontractors, unless they are operating as a company or have a certificate of exemption issued by Inland Revenue.
- Resident withholding tax on interest (19.5%, 33%, or 39% on election) is not deducted when paying interest of \$5,000 or more per annum to a non-financial institution/individual (unless a certificate of exemption is supplied). This tax is usually due on the 20th of the following month.

## Interest Deductibility

The IRD recently released its interpretation on deductibility of interest. It is probably more relevant to trusts, partners, qualifying companies, and individuals as they have to provide a nexus between the income earned and interest expenditure. Companies are automatically entitled to deduct interest.

Where it gets murky is when the funds are used to retain assets rather than produce income. According to the current view of Inland Revenue Department, it will allow an interest deduction if it is satisfied that there is a sufficient connection between the interest and assessable income. If the taxpayer can establish that *all* the following 3 factors are present then the taxpayer will have certainty of interest deduction.

These are:

- the taxpayer would definitely have realised the income-earning assets if they had not borrowed;
- the liability that the borrowings were used to discharge arose in connection with the income-earning assets retained;
- the liability that the borrowings were used to discharge was involuntary.

The above is Inland Revenue Department's approach to clarify its intention to allow interest deduction on funds borrowed to retain assets – however, if the above factors are absent, it will consider on a case by case basis.

## Charities

Charities that comply with the new Charities Act and are registered with the Charities Commission will continue to be tax exempt. Charities that fail to undergo the registration process will jeopardise their tax exempt status with the Inland Revenue Department.

**The Charities Commission has set February 2007 as the launch date for registrations and charitable organisations will have until 1 July 2008 to register before losing their tax exempt status.**

The registration process may be more beneficial to charitable organisations than deeming it as an unnecessary administrative exercise as it involves a review of the organisation.

There are a couple of forms that charities will be required to fill out (assumed to be in form of tick boxes) describing their purposes, activities, and operations and provide copies of the following:

- its governing document;

- its financial accounts (whether audited or not);
- information on the sector, sources of funds, beneficiaries etc.

The above information will automatically enforce a pre-review of the organisation because the governing document will need to ensure that:

- its purpose is adequate and is in line with its current activities;
- its officers are not disqualified people such as undischarged bankrupts or convicted dishonest offenders;
- its activities comply with the requirements under the Income Tax Act 2004, namely:
  - the charity is not for the private pecuniary profit of any person;
  - the charity deriving business income carries out its charitable purposes only in New Zealand;
  - no person exerting control over its business benefits from it.

## KiwiSaver

The KiwiSaver scheme will be in effect from 1 July 2007 after some amendments to the KiwiSaver Bill 2006 are made.

### What is it?

KiwiSaver is a structure that has been put into place by the government with the objective of helping New Zealanders increase their savings to support them in their retirement. The government is of the view that the scheme will reach a high proportion of people who are able to save and so instill a saving habit in these people.

It will be regarded as a registered superannuation scheme once it is amended for the purposes of membership in the Superannuation Schemes Act 1989.

### Who is affected?

Only New Zealand citizens and those entitled to be in New Zealand indefinitely under the Immigration Act 1987 who are under 65 years of age will be eligible to join the scheme.

However, in order to achieve its aims, the KiwiSaver does affect four broad groups. These are:

**Employees and other savers** – participation is compulsory for all employees aged between 18 and 65 starting a new job on or after 1 July 2007. Enrolment into the KiwiSaver will be automatically triggered for these new employees.

Existing employees, self-employed, beneficiaries and minors under the age of 18 may join the scheme voluntarily.

**Employers** – the scheme will use the employers to minimise costs and achieve economies of scale by employing existing processes in the workplace to deduct KiwiSaver contributions at source.

**Scheme Providers** – KiwiSaver schemes will be regulated in the same manner as a registered superannuation scheme, and it will be governed by Trust deeds where the trustees will be independent of the administration and investment managers of the scheme. “Independent trustee” is expected to be defined more clearly to ensure an appropriate trustee is allowed to act as one.

Existing superannuation schemes can either:

- Elect to become a KiwiSaver scheme;
- Establish a KiwiSaver scheme if they meet the criteria; or
- Continue to operate independently.

**Inland Revenue Department (IRD)** – It will be the central administrator of the KiwiSaver. It will also collect all the contributions made under the automatic enrolment rules in the first three months of the transitional period.

#### Contribution Rates

- A contribution rate of 4% of gross salary has been set. The employee can elect to make an 8% contribution, but a mid-point of saving is not allowed.
- Those who are automatically enrolled will be able to opt out of the scheme after the minimum period (envisaged to be between 6 – 8 weeks) under certain circumstances, such as, financial hardship or purchase of first home.
- The government has proposed to make an up-front contribution of \$1000 per person,

however, this amount cannot be withdrawn if the employee decides to opt out.

- The government will also subsidise the administration costs of the KiwiSaver schemes.

#### Employer Obligations and Options

Although the government intends to use existing processes to minimise costs, employers are likely to be faced with more compliance costs due to the obligations placed on them. These obligations include:

- Automatically enrolling all new employees.
- Educating new employees about KiwiSaver by distributing an information pack supplied by the IRD.
- Provide the IRD with the name, address and IRD number of all new employees and existing employees who opt in.
- Deducting contributions from their salaries and forwarding it to the IRD from their first pay.

Employers also have several options under the KiwiSaver legislation. They can choose to:

- Make voluntary employer contributions to KiwiSaver. These may be influenced by their own rules and conditions. These contributions will be tax-free to the employee.
- Elect an approved-KiwiSaver scheme for their employees who do not select their own. The employer will be required to provide an investment statement for the selected preferred scheme to their new employees.
- Convert their current superannuation scheme (if it has one) to a KiwiSaver scheme.
- Apply for an exemption from the automatic enrolment requirements if they have an existing registered superannuation scheme that meets certain criteria.

The foregoing merely summarises the main points of the KiwiSaver scheme where some amendments are yet to be legislated by Parliament. We will revisit it once it is established so watch this space in future.

## GST and Sale & Purchase Agreements

A purchaser in a Sale & Purchase agreement will often include a “nominee” where the nominated final purchaser may not exist at the time of signing of the contract. There could be a number of reasons for including a nominee, the common one being that an ownership structure may not have been finalised.

Problems may arise where the transaction involves the supply of a going concern. The GST Act requires the recipient of the supply ie the purchaser, to be registered for GST at the time of supply for the supply to qualify as a going concern.

It is common practice for a person with a nominee to enter into a transaction with the intention of that

nominee completing the purchase. If the nominee is not registered for GST at the time of completing the settlement, the transaction will not be a going concern.

The problem arises for the vendor if they have to pay the GST portion of the consideration because the agreement stated "inclusive of GST". On the other hand, the purchaser will be faced with a GST liability on the agreed price if the agreement stated "plus GST if any". In either case, there could be a potential dispute between the vendor and the purchaser if the transaction is a going concern and the purchaser is not registered for GST.

One possible resolution, depending on the circumstances of the transaction, could be the deeming provisions of the GST Act. The Act

deems a person to be registered for GST if that person's turnover is more than \$40,000 from when that person first became liable to register. Hence, if the supply was a business with a turnover of more than \$40,000 per annum then the purchaser would have been deemed to be registered from the time of supply.

However, there are no deeming provisions where the nominee does not even exist at the time when the settlement is completed! This could easily happen where a nominee company is yet to be incorporated and the director of that nominee company completes the settlement.

**Whenever Sale & Purchase agreements involve GST issues feel free to call us.**

## Changes from 1 April 2007

- GST return dates will be aligned with business balance dates. Those with 31 March balance date but with 28 February as their GST period date will have to file a GST return for the month of March 2007 so their GST periods are aligned to 31 March.
- GST will become payable by the 28<sup>th</sup> of the month except for the November period which will be due on 15 January.
- IRD numbers and GST numbers will change to 9-digit numbers. Existing ones will simply have a zero added in front of them.

## Other IRD Developments

- The income threshold at which New Zealand-based borrowers must begin repaying their student loans will rise from \$17,160 to \$17,784 on 1 April.
- The Government has enacted the legislation enabling Kiwisaver – this includes the foreign investment fund regime – **call us if your FIF is owned by in a company as there may be negative tax consequences.**
- Use-of-money interest rates for unpaid and overpaid tax will rise from 8 March 2007. The rate for unpaid tax will rise to 14.24%, while the rate for overpaid tax will rise to 6.66%.

Important: This is not advice. Clients should not act solely on the basis of the material contained in the *Client Newsletter*. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The *Client Newsletter* is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.