

# NEWSLETTER

August/September 2002

## FARMING SECTOR: USING INCOME EQUALISATION

Dairy farmers are about to bank the last cheque of the boom times. MAF has reported sliding incomes across all agricultural sectors.

The **Income Equalisation Scheme** allows farmers and those in land-based agricultural businesses to smooth their income by depositing funds to a central account in boom years and drawing the funds back down later on. The business gets a tax deduction when the deposit is made and returns the subsequent draw down as income in a later year.

Over the years the IRD has allowed taxpayers on an accountant's agency list to make deposits to the income equalisation scheme up to the 31 March of the year following the bumper year.

This means that you can still make a deposit to the scheme up until 31 March 2003 and take a tax deduction in your 2002 financial statements. The deposit for a 2002 deduction can be made after the

filing of your 2002 income tax return!

The specific wording about the timing of deposits to the scheme differs from the IRD's practice. The IRD is currently reviewing its position. If you have already filed your 2002 tax return and intend to make a deposit to the scheme, you must get in early!

Once your funds are deposited you will earn 3% pa interest providing the funds remain in the scheme for at least 12 months. The general principle is that you cannot withdraw the income equalisation deposit until 12 months have passed. The withdrawal will be treated as income in the year of your application to the IRD for the refund.

In some selected situations such as hardship, planned development and maintenance work and livestock purchases, you may be able to obtain the refund before 12 months is up. Please call if you want us to consider the income equalisation options and tax planning for your farming business.

## NEWS & VIEWS

### Provisional Tax

Saturday July 27 heralded a return of the Labour Government and therefore we are unlikely to see tax cuts this year. As the year progresses all businesses, including farmers, will be keeping a watchful eye on profits.

## CONTENTS

---

<b>FARMING SECTOR: USING INCOME EQUALISATION</b> .....	1
<b>NEWS &amp; VIEWS</b> .....	1
<i>Provisional Tax</i> .....	1
<i>GST in the Land of Oz</i> .....	2
<i>NZ'ers Investing across the Ditch</i> ..	2
<i>Sponsorship, Advertising or Something Else?</i> .....	2
<i>Updating the Charities Changes</i> ....	2
<i>Registers &amp; Requirements for Incorporated Societies &amp; Charities</i>	2
<b>BUYING A BUSINESS – PITFALLS &amp; PLANNING</b> .....	3
<b>PULLING TEETH WITH A TRADING TRUST</b> .....	3
<b>ARE YOU A NZ TAX RESIDENT?</b> .....	3
<b>TINY TAX REMINDERS</b> .....	4
<i>FBT Prescribed Rate of Interest</i> .....	4
<i>Changes to Payroll Administration</i>	4
<b>LESS FARM SPENDING BUT MORE BUILDING</b> .....	4
<b>A BIT OF FUN</b> .....	4

---

*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.*

Shifts in cashflows and income are a reminder to review your tax payments. Provisional tax is based on the tax calculated in your most recently filed tax return plus a margin. The margin presumes you will make more money this year than in the past.

If you think your profits will be a lot higher or lower than the provisional tax payments allow for, call us to change the amount or basis of your provisional tax calculation.

In the case of farming, many businesses have a balance date of May or June and based on these dates your next **provisional tax** date will be coming up on either 7 September or 7 October. Given the recent news we recommend that you call us to discuss your 2003 income level. We are happy to talk tax planning and legitimate tax minimisation opportunities with you.

### GST in the Land of Oz



The GST rules in Australia are more complex and a bit quirkier than ours.

One of the problem areas has been a limitation on NZ-based businesses wishing to register and claim back Australian GST. A NZ-based business could only register for Australian GST if the business was currently or intended in the future to **make supplies** in Australia.

The Australian Tax Office has amended the rule to give more flexibility. Businesses can now GST register if they have made purchases in or from Australia in connection with a business. There is no requirement to make supplies in Australia. This will allow businesses to register and claim back input GST if they have not started to sell in Australia, or are buying products or services for use in a business activity in another country.

We are happy to advise you on Australian GST registration and filing GST returns. Call us if this applies to you.

### NZ'ers Investing across the Ditch

Double taxation often occurs for New Zealand shareholders in Australian companies which have business interests here. The individual shareholder does not get any benefit from the imputation credits generated from the New Zealand sourced and taxed profits of the Australian company. The reverse problem applies for Australian shareholders in New Zealand companies which also earn profits in Australia. Examples of companies operating on both sides of the ditch include: Baycorp, Telstra, Telecom, and Nufarm.

The result is that if you currently invest in an Australian company you receive no benefit for any NZ tax already paid by that company on its New Zealand operations. The Australian franking credits appearing on your dividend advice notice are worthless and you will be taxed again on the dividend income.

A Discussion Document Proposal considers changing our tax legislation to allow companies to keep separate tax credit accounts for the tax paid by the company in Australia or New Zealand. The company could then track those credits and attach them to shareholders in the respective countries. NZ shareholders will receive a useable "imputation credit" and Australian shareholders will receive a similar "franking credit". If this goes through, it will be a welcome improvement for small shareholders.

### Sponsorship, Advertising or Something Else?

Much confusion reigns about gifts / advertising / donations and sponsorship. The IRD has released a draft statement setting out guidelines for claiming sponsorship expenditure as a deduction.

In order to claim an income tax deduction for **sponsorship** spending you will need to be able to demonstrate that you received something in exchange for the sponsorship money paid. For example, if your business sponsors a local sports team you might agree that the team will wear clothing bearing your business logo and use your business name. You will get promotional coverage and name visibility in exchange for the sponsorship dollars spent.

We recommend that major sponsorship decisions are referred to us before you commit the money. This will ensure that you can obtain a deduction and don't get any surprises!

### Updating the Charities Changes

The IRD has issued a second paper on Tax and Charities. One welcome change proposed should make it easier for individuals to receive tax rebates on donations to charitable organisations operating overseas. The current list of approved organisations has had only two additions in the last seven years.

A second significant change is proposed to the definition of "charitable purpose". For Non-profit bodies and charities any funds received for a "charitable purpose" are exempt from income tax. There has been uncertainty as to the tax treatment of donations and grants listed by the charities to promote things that are wider than the organisations charitable purpose. In some instances funds used for sport, culture and the arts will be subject to income tax. A better definition will give certainty as to the taxability of charities' income.

### Registers & Requirements for Incorporated Societies & Charities

The Registrar of Companies also oversees Incorporated Societies and Charitable Trusts. Once established, a society or charitable trust must register with the Companies Office. Any changes to the organisation's

guiding precepts must also be advised to the Companies Office. Charitable trusts do not have any ongoing reporting requirements, simply the initial registration step.

Incorporated Societies have an ongoing reporting requirement. At the end of each financial year an incorporated society is required to prepare financial statements and submit these to an annual general meeting. Once approved, a copy of the financial statements must be forwarded to the Registrar of Companies.

The Registrar recently tidied up the Incorporated Societies Register and as a result some 2,714 Incorporated Societies were removed. These organisations were no longer active and had failed to file the required information.

Useful general information about incorporated societies and charitable trusts can be found at [www.companies.govt.nz](http://www.companies.govt.nz) under Information Library. The list of removed societies appears under Removal & Restoration Notices.

## BUYING A BUSINESS – PITFALLS & PLANNING

When you are considering buying an existing business, we encourage you to look carefully through the books, evaluate the assets and liabilities and decide which parts of the business are of interest. A sale and purchase agreement will be drawn up and, when both parties have agreed to the terms and conditions, the purchase will go ahead. Often we are asked: “Should I buy the shares in the company or buy selected assets and liabilities?”

**Your decision** as to what to buy will depend on whether the vendor wants to sell the company lock, stock and two smoking barrels or is happy to separate the business from the company. If you buy the shares of an existing company you are buying not just the situation as you see it today, but the company’s history as well. In the event of an IRD investigation into the company’s history, you will be

responsible for any past tax shortfalls uncovered. A scary thought!

*What can you do?* Traditionally indemnity clauses are used to give the purchaser some protection and a means of recouping costs if things come unglued. In an interesting case, the notion of a tax indemnity was tested. The judge decided that the indemnity did cover a variety of costs, including the legal costs of dealing with a tax assessment covering transactions before the purchase. A tax indemnity clause in a sale and purchase agreement would require the vendor to cover the purchaser in the event of a tax investigation. The cover could include some or all of: tax payable for prior years, penalties and interest charged, and accounting and legal costs associated with an investigation.

Indemnity clauses are impossible to enforce when the seller disappears or ends up broke. You will probably achieve a better overall result by examining the assets and liabilities of the business and selecting the parts that you want rather than taking on the company. Leave the vendor with any problems and liabilities!

If you are considering purchasing a business, talk to us first. We can work with you to ensure that you consider the key issues and achieve a practical, workable result.



## PULLING TEETH WITH A TRADING TRUST

**What is a Trading Trust?** A trust which carries on a trading activity. A trading trust provides a way of allocating net business income to beneficiaries on lower tax rates without the tax inefficiencies that can occur in a conventional trust. However, with the advent of the 33% tax rate for minor beneficiaries this advantage can be limited.

*How does this differ from a Conventional Trust?* Conventional trusts usually hold passive investments. Much of the income received by the trustees will already be taxed and have attached tax credits. Any excess imputation credits will convert to losses in the beneficiaries’ hands.

The IRD has not favoured trading trusts. They have particularly opposed the transfer of an existing business into a trading trust. A recent tax case concerned a dentist in a dentistry partnership. The dentist restructured his business affairs using a trading trust. Although the IRD claimed that the dentist had avoided tax, the Courts decided that the first year tax saving was a sideline benefit. No conclusion was reached as to whether future tax savings would be regarded as tax avoidance.

During the case discussions the IRD acknowledged that businesses starting out are permitted flexibility of business structures based on corporate and trust models without there being any suggestion of tax avoidance. It appears that if the dentist had set up a trading trust when first going into business, the structure would not have been challenged.

As with any structure, trading trusts have both benefits and pitfalls. If you are starting out in business or considering a reorganisation we are happy to talk through your structuring options.

## ARE YOU A NZ TAX RESIDENT?

New Zealand’s tax system is based on two broad notions:

- **Residents** of New Zealand are taxable here on their worldwide income
- **Non-residents** are taxed here on their New Zealand sourced income only

If you are going on an OE or perhaps you are temporarily based here, it will be important to work out whether you meet the definition of a

*tax resident.* Note that residency status for immigration purposes is quite different to being a *tax resident.*

If you are already a New Zealand tax resident and are away from New Zealand for more than 325 days in any 12-month period, you become a non-tax resident provided you do not have a “permanent place of abode” in New Zealand. You will have a “permanent place of abode” here if you have an enduring relationship with New Zealand.

An enduring relationship is established by considering:

- Presence in New Zealand
- Accommodation
- Social and economic ties
- Employment or business activity
- Personal property
- Intentions
- Benefits and other payments

(It will usually take more than one of the above to form an enduring relationship.)

If you do have an enduring relationship, you will continue to be a resident for tax purposes even though you may be away for more than the 325 days.

On the other side, if a person who is not already a New Zealand *tax resident* is present in New Zealand for more than 183 days in a 12 month period, then the individual is deemed a tax resident.

New Zealand also has tax treaties with a number of countries. The tax treaties can alter an individual’s tax obligations in each country. If you know of people who are considering leaving New Zealand or entering the country for an extended period of time, encourage them to check out the tax issues. Careful planning can help to minimise their total global tax payable.

Trusts and companies have their own specific rules about residency. If you are planning to leave or enter the country, there is definite merit in seeking New Zealand based professional advice before you move.

## TINY TAX REMINDERS

### FBT Prescribed Rate of Interest

The IRD has revised the rate of interest for calculating the fringe benefit value of low-interest, employment related loans. On 1 July 2002 the rate increased from 6.7% to 7.5%.

### Changes to Payroll Administration

The only constant in the world of ACC is change! From 1 April 2002 ACC will be the collection point for ACC cover and residual levies. ACC will collect your IR348 Employer Monthly Schedule information from the IRD, calculate your liability and invoice you directly.

The old IR68A form which summarised payroll data for the full year and calculated the ACC residual levy is no longer required for 2002 year.

## LESS FARM SPENDING BUT MORE BUILDING

The ASB Bank Chief Economist offers the following comment on the economic outlook.

Political uncertainties, falling global share prices, lower farm incomes – one can be forgiven in recent weeks for becoming a little pessimistic about the economy. However, all is not bad. Three points are noteworthy.

Government actions are unlikely to influence the macro economy over a 2-3 year time frame. The days of election-induced business cycles are gone. Nowadays the near-term driving forces come more from international events and population flows. Plus, the momentum from firms testing the plans and strategies that have gradually evolved from the mid 80s reform period.

Looking offshore for direction, the situation is mixed but underneath the ailing share markets are economies that are generally picking up after the recessions of 2001.

There is, of course, a risk that falling share prices may force businesses and households globally to revisit their spending decisions but there are also other factors to consider: house prices are generally rising globally and interest rates will remain low for a longer period. Together the outlook is for moderate global economic growth rather than recession.

A similar mixed outlook applies at home. Global growth will underwrite local growth via higher tourism and exporting generally. And while international growth is not sufficient to prevent lower dairy product prices, there will be the countering influence of high immigration and hence more building activity.

In all these mixed forces suggests a moderate NZ economic growth rate over 2002/03 but with some very different experiences between city and farm. And, while this type of environment points to some pause in the upward interest rate trend, it will do little to prevent the NZ dollar from returning towards the 57 US post-float average. That again will depend on international trends but, in this case, the over-riding influence of a weakening US dollar is expected to persist for some quarters yet.

## A BIT OF FUN



### On the Demise of Big American Companies

*“Where there is a sea there are pirates.”*

### On Contracts

*“The large print giveth and the small print taketh away.”*

### On Taxation

*“The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing.”*

*If you have any questions on newsletter items please contact us, we're only too happy to help.*