AUGUST 2016

THE Client Link

IN THIS NEWSLETTER

MORE TAX CHANGES AFOOT

The Inland Revenue Department and the Government have recently introduced a multitude of tax changes. We outline some of the important ones below:

More on company cars and FBT
From 1 April 2018, the Government is proposing to let close companies (most small companies) calculate the private use of a company car in the same way as a sole trader. You will have to keep a log book and apportion the costs. However, you will also need to make an adjustment for GST on the car, as well as its running costs. For many people the log book idea is going to be more hassle than it's worth. This option will be available only provided there are no other fringe benefits and no more than two vehicles are involved.

If, when the law is changed, you prefer to keep a log book and avoid fringe benefits tax (FBT), tell us. Remember, however, your compliance costs will increase a little. There'll be calculations to make and GST adjustments to do. FBT is a quick, easy and economical method of adjusting for private use of a vehicle. It will often give you a more favourable result, **but not always**.

Use of home
There is a proposal to change the rules for claiming "use of home". For years, Inland Revenue has said that to make a claim for this cost you must set aside a room as an office. This isn't quite true. A court case some years ago settled this matter. You can apportion the cost of a room used for business between your business use and family use, based on the time each activity uses the room.

Now, the IRD is planning to get its rule enshrined in the law, so if the law changes, you will need to have a room set aside as an office, if you want to claim for the use of a room for business. To make claiming this cost simpler, the department plans to set a rate for utilities per square metre ($x for power etc). You will add your adjustment for rents, rates and interest. You won't have to use the IRD calculation but it might save you hassles if you do. The bigger the power bill, the more likely you won't want to use the IRD rate.

Shareholder/employees
Currently, you are either a provisional taxpayer or you get a PAYE salary. A mixture of the two is not strictly permitted unless the provisional income is at least half the PAYE salary. In practice, it makes very little difference and for this reason, the Inland Revenue Department is proposing to do away with the restrictions and allow shareholder employees to take a PAYE salary and then top up their incomes at the end of the year, once the profit is known. We look forward to this change becoming law.

Read Every Word of Insurance Policies

Strangely, one of the biggest risks in business is our insurance policy. We're all familiar with the problems Canterbury people have had with their home insurance. If ever there's was a document you need to read very carefully it is your insurance policy.

We've heard of someone buying travel insurance for a six-week period only to find, when a claim was lodged, that the policy was limited to a maximum of one month away from the country. Read every word of your insurance policy and if there's anything which is not clear or looks as if it's not covered, raise the matter with the insurer or agent. Make sure you get a response in writing. A telephone conversation is not enough.

Debt Forgiveness

It may seem extraordinary but if someone forgives you a debt, from a tax perspective, you have taxable income unless the debt is forgiven for natural love and affection. In this context the lender can only have natural love and affection for their relatives or a trust where those relatives are beneficiaries.

If you're structuring a business deal, don't include debt forgiveness. For example, A says to C: "I'll sell you my shares for $40,000 and forgive you the debt you owe me of $10,000". It would be better to sell the shares for $30,000 and insist on the debt being repaid.

CHILDCARE AND WINZ SUBSIDIES

On the back of a low dairy payout, we have received a number of phone calls from clients wanting to know if childcare costs are deductible. In these cases, the clients are looking to reduce farm working costs by having both partners working on the farm and in the shed. To do this, they are considering getting a nanny or au pair to assist with childcare.

In doing this, the wage costs are reduced as the farm operates without the need for any employees, or in the case of larger farming operations, with fewer employees.

The question arises of what happens with the children and how they will be looked after while both parents are working on the farm?

If the parents are in the shed, then a kids' room or a portable cabin may be appropriate. But when the parents are elsewhere on the farm, other options need to be considered; like a nanny or au pair.

What Assistance is Available

Although the childcare expense is not deductible, some assistance may be available to farming families. Work and Income New Zealand (WINZ) offer a number of childcare subsidies to eligible families.

The Childcare Subsidy (CCS) allows parents to choose between receiving the Childcare Subsidy or 20 hours ECE, or in some cases, a combination of both. This Early Childhood Education subsidy can be used for approved home based care for children. The amount of the subsidy depends on the size of the family, income and number of hours of childcare provided.

BUSINESS WISDOM FROM JOHN BORGHETTI

Doug Nancarrow has written a biography of John Borghetti, who never got a tertiary education but still got almost to the top of Qantas and became the CEO of Virgin Australia. Borghetti is quoted in the book as saying, "The CEO has two main tasks, which are to:

- set the strategy;
- keep the staff on side to deliver that strategy."

From your perspective, the message is to work with your staff to help them deliver the goods. Avoid criticising – none of us is perfect. Instead, take a positive approach to helping them succeed at their job. If you really have to correct someone, there's a right way of doing it. Start by imagining you were the employee and work out how you would feel. What can you do to soften the blow? If that doesn't work, you may have employed the wrong person.

When hiring staff Borghetti doesn't look at the CVs. Instead, he likes to get the candidates talking about their home lives to get an insight into their ethics and personal values.

At the end of the book he lists 10 lessons he has learnt about business. One good one is the importance of relationships. While it is obviously true that keeping a good relationship with your customers is crucial, don't forget your suppliers and your staff. Keep them on side. For staff, don't forget "those who play together stay together".

BEING A TRUSTEE CARRIES RESPONSIBILITIES

Every so often we remind clients of the risks involved in being a trustee. It doesn't matter whether the trust is a family trust or a charitable trust. Trustees are directly responsible to the beneficiaries for their management of the trust assets. Beneficiaries can sue trustees. In a family trust, it is not necessarily a beneficiary who causes the trouble. It can be the spouse of the beneficiary who makes the bullets. There are also obligations to the Inland Revenue Department. Until you advise Inland Revenue you've ceased to be a trustee, you're still personally responsible for its taxes.

Wait for profits

Also from a tax perspective, you should remember if the trust makes losses they can't be passed out to the beneficiaries. You have to wait until the trust makes profits before you can use up the losses. So, if you buy an asset which is expected to generate on-going losses for some time, it might be better to not have it owned by your family trust. Perhaps it should be owned by someone who can use the losses to save tax. It can be transferred to the trust for asset protection purposes at a later time. This would normally be when it's making profits (trustees don't generally want loss making assets) but, of course, this may mean additional costs.

Don't be passive

There is no such thing as a passive trustee. If you choose to be passive, be it on your own head. Some years ago X and Y were appointed trustees of a family trust. Immediately, they decided they would hold quarterly meetings. At one of these meetings one of them proposed the trust should take out an insurance policy on a factory owned by the trust, for loss of rent in the event of fire or other accident. Two years later the factory burnt to the ground. This serves as a very good example of how trustees ought to operate. They ought to hold regular meetings and minute decisions made.

Interference

What if the person who set up the trust wants to interfere? Maybe he/she didn't want to incur the premiums for taking out that loss of rents insurance policy. The answer is simple. If you're a trustee, it's your job to steer the ship. Your responsibility is to look after the interests of the beneficiaries. You and your co-trustees make the decisions. If anyone starts to bring pressure on you to do as they wish, the correct course of action is to resign. Above all, never be a passive trustee.

TAX ON CAPITAL GAINS

Are capital gains taxable? Yes, in some circumstances they are. For example, if you buy a property with the intention of selling it for a profit, regardless of how long you have had it, that profit is taxable.

We noted an article in a national daily paper dated 13 July concerning interest-only loans. The Reserve Bank says 40% of loans are interest-only and 47% of loans are to investors. If you buy a rental property and finance it substantially with an interest-only loan and don't make any effort to reduce the debt, some – including Inland Revenue – might argue your investment was made with the intention of getting a capital gain. That would mean your gain, when you sell, might be taxable. There may be other valid reasons why the debt is structured this way. Just be careful.

BRIEFLY

The Biggest Lies in Business

The biggest lie in business used to be: "The cheque is in the mail." It's now: "We are experiencing an exceptional volume of calls at the moment", or "We value your business...". If you're a small or medium sized business, don't copy big brother. Give your customers a fantastic telephone reception. That's one way to beat the big guys.

Want to Buy a House

It's easy to sell a property at the moment, but if you're a buyer, get sorted before putting in a tender or going to auction. This includes making sure you have builder and LIM reports, you have been back to the bank within a week of the tender date to confirm your finance is OK, and you've taken legal advice, as needed. Ask yourself, is it better to accept an unconditional offer for, say, $600,000 or a good conditional offer of $610,000? Most people will take the unconditional offer.

Reverse Mortgages

Oldies often run out of money and they are sometimes helped by their children. There's usually an understanding that when the parents die, the children will be repaid out of the estate. These arrangements should be documented. Otherwise disputes can occur as to who lent money and how much. A new business has been created to take care of family loan issues. If you're interested, go to the website www.familyloans.co.nz

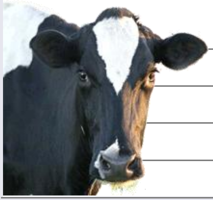
2017 FONTERRA DAIRY PAYOUT

Fonterra have announced that the 2017 dairy payout is predicted to be $4.25/kg ms. The opening advance rate for June 2016 production (paid July 2016) is $2.50/kg ms. The capacity adjustments for the season is $0.51/kg ms for milk produced between June - August 2016 and January - May 2017.

While the $4.25 price per kg ms is the publicised dairy payout, this amount is paid to the farmer over a 16-month period (July - October 2017). The actual amount that a dairy farmer receives can be very different. It will depend on the previous season's payout, Fonterra shareholding, capacity adjustments and production dates.

The following table shows how the 2017 Fonterra payout of $4.25/kg ms is made up.

2016/2017 Season Forecast Payments



	Mar 2016	May 2016
Paid 2016 financial year	$3.30	$3.35
Paid 2017 financial year	$0.71	$0.66
Capacity adjustment	$0.24	$0.24
	$4.25	$4.25

The capacity adjustment is $0.51 cents per kg ms paid for milk produced over the off peak production. This works out to approximately $0.24/kg ms for an average farmer's full year production. The farmer will also receive retrospective dairy proceeds from the 2015/2016 season of $0.50/kg ms. Based on this, a Fonterra supplying dairy farmer with a May balance date would receive the following milk payments:

- $3.35 for 2016/2017 supply
- $0.50 retrospective payments for 2015/2016 supply
- $0.24 capacity adjustment (will vary between farmers)

Assuming that the 2016 and 2017 production is similar, this works out to $4.09/kg ms. The farmer is fully shared up with the required Fonterra shares from which they would also receive a dividend, although the amount is yet to be confirmed.

LAND SALES AND THE BRIGHT-LINE TEST

The Bright-line Test for land sales applies from 1 October 2015 and requires taxpayers to pay income tax on gains derived from the sale of residential land that has been owned for less than two years. Exemptions exist for the gains made on the sale of the main family home.

The Bright-line Test does not apply to 'farmland', which is described in section YA 1 of the Income Tax Act 2007 as "*land that is worked in a farming or agricultural business of the land owner, or worked as a farming or agricultural business because of its area or nature*".

The definition identifies two categories of farmland. The first is where the land is being farmed. The second is where small parcels of land that are unable to be farmed individually can be farmed collectively.

The land sales that are most at risk of being caught by the Bright-line Test are sales of lifestyle blocks, farm cottages and bare land that is not capable of being farmed.

LYNCH & PARTNERS
CHARTERED ACCOUNTANTS

Waihi Office:
6 Rosemont Road, Waihi

Tel: (07) 863 7372

Paeroa Office:
25 Willougby Street, Paeroa
PO Box 11
Tel: (07) 862 8643