

YEAR END STRATEGIES

THE 2008/2009 TAX GUIDE FOR YOU AND YOUR BUSINESS

SURVIVING THE DOWNTURN

KEEP AS MUCH AS YOU CAN BY EFFECTIVE TAX PLANNING

As concerns over the global economy continue to grow, it is essential that all individuals and businesses are well prepared for financially-testing times. Sound business and financial planning are always important, but especially so in an economic downturn.

The financial turmoil may have you wondering whether you will have enough money to send your children to university, to pay for your own retirement, or to meet your other financial goals.

Effective tax planning is a year-round, lifelong activity, and though constantly changing tax law can make planning a challenge, making it a priority will pay off with lower taxes. We are committed to working with you to find the tax strategies best suited to your individual circumstances. If you have questions about anything in this newsletter or about your tax-cutting options, please call. And if you have friends or associates who might be interested in end of year tax planning information, feel free to share this newsletter with them.



R&D CREDIT COMES TO AN END

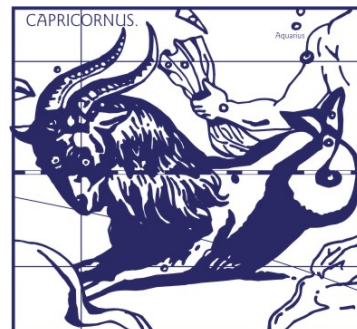
The Research and Development (R&D) tax credit introduced on 1 April 2008 will be abolished after 31 March 2009, after having run for only one year.

The R&D tax credit system currently allows eligible businesses to claim a tax credit of 15% for eligible expenditure. This means that in the 2008/09 income year, the credit remains available for qualifying expenditure on R&D activities. If the expenditure does not become eligible for a credit until the following year, it will not attract a tax credit. However, the expenditure will generally be tax deductible and the additional 15% tax credit will no longer be available after the end of this year.

Those intending to make a claim should make sure they identify eligible R&D projects and collect the necessary documentation to prove their claim. Businesses need to identify those projects that are eligible and collect the supporting documents and cost details from existing information. The claim is then made by submitting an R&D form online directly at IRD.

IN THIS GUIDE

- Surviving the downturn
- R&D credit comes to an end
- Year end tips for property owners
- Associated persons rule - the fine print
- Prepare for changes to KiwiSaver
- Increased audits of LAQCs by IRD
- Imputation credits deadline nearing
- Year end checklist for business owners



CAPRICORN GROUP

PO BOX 8010,
KENSINGTON
WHANGAREI

•
TEL 09 459 4406
FAX 09 459 4416

•
E-MAIL
fenton@capricorngroup.co.nz

•
WEBSITE
www.capricorngroup.co.nz

•
PRINCIPAL
Fenton Peterken BMS(Hons)

CA
•
PARTNERS
Jonathon White

•
Property Specialists
Insurance
KiwiSaver
Mortgages

YEAR END TIPS FOR PROPERTY OWNERS

✓ EDUCATION COSTS

You may claim the cost of obtaining educational material such as investment related books, seminars and magazines.

✓ LAQC LOSSES

Shareholders in a LAQC are able to claim the losses from a LAQC and offset them against their personal income.

✓ TRAVEL AND CAR EXPENSE

Motor vehicle and travel expenses incurred as a result of managing your property are generally deductible. Ensure that adequate records are kept.

✓ CAPITAL ITEMS

Capital expenditure incurred to buy or improve the value of a property is not deductible. This not only includes the capital part of a loan repayment, but also legal or accounting fees incurred when purchasing a property.

✓ REPAIRS AND MAINTENANCE

Review expenditure on repairs. The cost of repairs on investment properties are deductible but care needs to be taken as expenditure that may be considered an improvement may not be treated as a deduction.

✓ LEGAL EXPENSES

Legal costs incurred to finance a purchase is deductible. However, legal costs incurred for buying a property are not.

✓ CLEANING AND PEST CONTROL

Cleaning both the interior and exterior of a property is deductible, as are costs for pest control.

✓ LAQC SHAREHOLDING

Review continuity rules that must be satisfied in order to qualify for LAQC status and ensure IRD is notified of any changes to shareholding.

✓ INTEREST

Interest can be deducted if borrowed funds have been used to purchase investment property. Be prepared to prove the interest claim where a loan has been used for both investment and private purposes.

✓ GET A CHATTELS VALUATION

A professional chattels valuation will mean that assets are valued correctly, maximising your depreciation claim. The cost of a chattels valuation is tax deductible and will also help validate any claims that are made for depreciation.

ASSOCIATED PERSON RULE - THE FINE PRINT

The Taxation (International Taxation, Life Insurance and Remedial Matters) Bill introduces new 'associated persons' definitions in a way that a taxpayer may be deemed an 'associate' of people and entities he or she may not even know exist.

One of the proposals of the Bill is to replace the relatively narrow definition of 'related person' with the wider 'associated persons' definition applying from 1 April 2009.

It is essential to know when two persons are associated for tax purposes. The tax consequences of some transactions can differ significantly and certain tax concessions may not be available if the parties involved are 'associated persons'. The present definition of 'related person' is relatively narrow, making it easier, for the time being, to structure a non-related purchasing entity.

If the Bill passes in its current form the situation will differ dramatically. There will be many circumstances when it comes to determining the tax treatment of personal or business investments, in which it will be important to understand what entities are associated.

Specific circumstances may include:

- selling a property in which case it will need to be determined whether or not tax is payable on the proceeds of the sale.
- arranging for your company to sell some of its land. In this instance, the extent to which a company may distribute a capital gains from the sale tax free upon liquidation needs to be determined to be established.

If the Bill proceeds to schedule, the new associated persons definitions will apply to the 2009-10 and later income years for all provisions of the Act except the land provisions. For the land provisions, the new definitions will apply to land acquired on or after 1 April 2009, raising issues for property developers.

Given the time frame for implementation of the Bill, issues that need to be taken into consideration now are:



- who you, your trusts and companies will be associated with under the new definitions.
- whether any existing business structures you have in place need to be reviewed in light of these new definitions.

If you are looking to restructure capital assets such as land and buildings, intellectual property, goodwill or shares that may realise a capital gain on transfer, then you may need to consider a restructure before these changes take effect.

TOUGH TIMES TIP 1 RETAIN KEY STAFF



Some businesses will be forced to make job cuts from time to time. Before you begin reducing staff, keep in mind the cost of rehiring and training when things improve.

PREPARE FOR CHANGES TO KIWISAVER

The government introduced the Taxation (Urgent Measures and Annual Rates) Bill into Parliament on 9 December 2008. The Act makes a number of significant changes to KiwiSavers effective from 1 April 2009.

Employee Contribution rate. The minimum contribution rate for employees will be reduced from 4% to 2% of gross wages from 1 April 2009 and will become the default rate for new members. Existing KiwiSavers and complying superannuation fund members are able to retain current contribution rates, but may elect to reduce contributions to the new rate.

Employer Contributions rate. The new minimum matching contribution rate for employers will also be reduced to 2% from 1 April 2009, with no further progressive increases. The transitional rules that permitted employees to make contributions at reduced rates until 31 March 2011 will also cease to apply from 1 April 2009.

Employer Tax Credit. As a consequence of the reduced employer contribution, the employer tax credit will be discontinued from 1 April 2009. Employers will initially absorb the full cost of removing the tax credit until the cost benefit of the reduced employer contribution is realised. In some cases the removal of the employer tax credit will mean increases in remuneration costs. The KiwiSaver Act will also be amended to ensure that no employee can have their gross salary reduced as a result of employer contributions.

Full member tax credit. The full member tax credit will continue to be calculated on the level of contribution paid by the member up to the existing maximum of \$1,040. This means there is flexibility for



those earning less than \$52,000 a year to contribute at more than the 2% minimum rate or make additional lump sum contributions if they wish to maximise the credit available. It also means that non-employee KiwiSavers will be able to continue to contribute the amount required to maximise the credit.

Employer Superannuation Contribution Tax Exemption. The Employer Superannuation Contribution Tax (ESCT) exemption for KiwiSaver and complying superannuation funds will reduce from 4% to 2% from 1 April 2009. It will also expose employers who contribute between 2 and 4% to ESCT for the first time, introducing further compliance costs, and acting as a real disincentive to contribute beyond the statutory minimum.

Fee subsidy. The \$40 per annum fee subsidy will be discontinued from 1 April 2009.

INCREASED AUDITS OF LAQCS BY IRD

Inland Revenue has signalled its intention to increase audit activity of private homes held in Loss Attributing Qualifying Companies (LAQCs).

Inland Revenue has stated that this process is being adopted to ensure that taxpayers are aware of its concerns about private homes held by LAQCs and to give taxpayers the opportunity to correct their affairs, if necessary before audit activity commences.

The practice of greatest concern involves individuals selling their home to a LAQC, then renting the property back and claiming tax deductions for expenditure on the property that is ordinarily considered to be of a private nature. In total these expenses exceed the rental income. The loss is then attributed to the shareholders under the LAQC rules, and they offset this loss against their other income.

The Commissioner's view is that this type of use of a LAQC is a tax avoidance arrangement on the basis that many of the expenses would not be deductible if the home was personally owned. It does not matter if a commercial rent is paid.

If the Commissioner decides that the arrangement is one of tax avoidance or tax evasion, deductions that are considered to be private in nature will be disallowed. This will usually mean that past returns will be reassessed. Taxpayers may also be liable for late payment penalties and use of money interest.

If you are involved with this type of arrangement, it would be advisable to contact our office to discuss this matter and any remedial action required.

LAQC DEADLINES

With 31 March fast approaching, here are a few reminders to ensure the IRD accepts LAQC elections:

1. Existing companies must file valid elections before the beginning of the tax year.
2. New companies must file a valid election on or before the due date for their first return.
3. Invalid elections will not be accepted and no extensions will be permitted.
4. Where companies have a trust as a shareholder, the IRD requires all trustees and beneficiaries to make the election. Ensure that the names of the trustees and beneficiaries are on the election.
5. Confirm the company holds LAQC status before filing the income tax return, otherwise processing the return may be delayed.

TOUGH TIMES TIP 2 DO A WEEKLY CASH FLOW FORECAST



During times when business is slower and unpredictable, it is essential to maintain a weekly cash flow forecast. Even some simple cash flow planning can prevent your business from disaster.

IMPUTATION CREDITS DEADLINE NEARING



The company tax rate dropped from 33% to 30% from the beginning of the 2009 income year, changing the way in which imputation credits are allocated to dividends. This means that 33% and 30% credits need to be recorded separately.

The transitional period operating from 1 April 2008 through to 31 March 2010 is intended to allow companies adequate time to fully use imputation credits. During the transitional period, it is necessary that a company keep track of both its 33% credits (attributable to pre-31 March 2008 earnings) and 30% credits (attributable to post 1 April 2008 earnings).

Companies need to be fully aware of the issues involved with imputation credits. These include:

Overdrawing of credits. Companies must ensure that they do not inadvertently overdraw the balance of the 33% account. If the balance of the 33% credits is overdrawn at 31 March 2010, a special penalty could apply.

Taxation refunds. Any refund of tax that relates to a 33% period will reduce the balance of the 33% account. Failing to take this into consideration could result in overdrawing.

Balance dates. The transitional period remains the same for both companies with a standard and non-standard balance dates. That will mean for companies with an early balance date, the transitional period will be longer. Companies with a balance date later than 31 March will have a transitional period of less than 2 years.

Distributing imputation credits benefit shareholders by reducing their personal tax liability, unless that liability is already zero. Some companies may not have sufficient cash to make a distribution before the end of the transitional period. And with the tightening of the financial markets, they may be unable to borrow funds to distribute sufficient dividends to use up all 33% imputation credits. One option that companies may have available is to make a taxable bonus issue to shareholders that use the company's 33% imputation credits.

Any 33% credits that have not been used by 31 March 2010 will be carried forward as ordinary credits and held permanently as excess input tax credits as the maximum credit ratio after 31 March 2010 will be 30:70.

TOUGH TIMES TIP 3 REVIEW YOUR FINANCIALS



It is easy to get distracted and suddenly find that margins are squeezed and sales are falling. Your profit and loss statements and balance sheets are not just for year end. Keeping an eye on these reports can mean the difference between success and failure.

YEAR END CHECKLIST FOR BUSINESS OWNERS

- ✓ **YEAR END PHYSICAL STOCK TAKE**
A physical stock take may uncover stock losses and also verify stock levels recorded in your computer system.
- ✓ **ENTERTAINMENT EXPENSES**
Entertainment expenses are only 50% deductible. Ensure that records explain why the entertainment costs were incurred.
- ✓ **STAFF BONUSES AND EMPLOYEE HOLIDAY PAY**
Accrued holiday pay and bonuses paid within 63 days of balance date are deductible at 31 March 2009.
- ✓ **UPDATE COMPUTER SYSTEMS**
Ensure that payroll software is updated and ready for the new personal tax rates effective from 1 April 2009.
- ✓ **LEGAL COSTS**
Ensure that legal costs associated with capital items can be identified easily. Legal costs of a capital nature are not deductible.
- ✓ **WEBSITE COSTS**
If a website has been setup during the year, the costs must be capitalised. Ongoing costs and maintenance, on the other hand, are tax deductible.
- ✓ **GST ON EXPENSES**
Taxpayers have two years to claim GST on expenses. It is advisable that any outstanding GST claims be reviewed as part of the end of year process.
- ✓ **REPAIRS AND MAINTENANCE**
Review all spending during the year to determine if all items are deductible or if they are capital by nature and need to be depreciated.
- ✓ **BAD DEBTS**
Review all bad debts before year end. To claim a deduction the bad debt must be written off the debtors ledger before 31 March 2009.
- ✓ **FIXED ASSETS**
Review last year's fixed asset register to determine if assets listed still exist. Assets can be written off, provided that they are no longer in use, there is no intention of using the asset and the disposal value is less than the cost of disposal.

We Are Here To Help

Make good use of us! This guide is merely a starting point, designed to help you identify areas that might have a significant impact on your tax planning.

Please keep us informed of your plans and consult us early for help in taking advantage of tax-saving opportunities and tax efficient investments.

