NEWSLETTER

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## INSIDE THIS EDITION



**Merry Christmas**

The Directors and staff at Fluker Denton would like to wish you all a happy Christmas and New Year. We hope you have a great Christmas and New Year break.

We have enjoyed working with you over the last year and look forward to seeing you in the New Year.

The office will be closed from 3pm Tuesday 23 December 2014, re-opening at 8am Monday 5 January 2015.

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# Reduced financial reporting requirements for SMEs

Recent changes to the Financial Reporting Act 2013 (FRA 2013) have changed the requirements for entities that are not "large" by definition.

Broadly, this means that most NZ businesses will no longer have to prepare financial statements that comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP). Recognising that this could lead to a reduction in the disclosure of financial information by a business, the IRD has introduced its own minimum standards. The standards are aimed at providing the IRD with a basic level of information so that it can adequately assess a business's performance.

From 1 April 2014, the IRD requires companies (including look-through companies) that have annual revenue of $30 million or less, and assets of $60 million or less (or subsidiaries of multinational companies with less than $10 million of annual revenue and assets of less than $20 million) to prepare financial statements that meet its stated minimum requirements.

Entities that exceed these thresholds are required to prepare more extensive financial statements as per the standards set out by the External Reporting Board.

Some extremely small companies will be exempt from the IRD's minimum requirements, as follows:

- Companies that:
  - are not part of a group of companies, and
  - have not derived income of more than $30,000, and
  - have not incurred expenditure of more than $30,000 in an income year.
- Non-active companies who are not required to file a return.

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**Minimum Requirements**
Under the IRD's minimum requirements, the financial statements must contain:

- a balance sheet setting out the assets, liabilities and net assets of the company at the end of the financial year,
- a profit and loss statement showing income derived and expenditure incurred for the year,
- a statement of accounting policies describing the basis on which the accounts have been prepared, and a description of any material changes in accounting policies used since the previous income year.

The statements must be prepared using double entry and accrual accounting principles. There are also certain valuation principles that may be applied. Tax values may be used where they are consistent with double entry and accrual accounting, or historical cost when tax values are not consistent with the accounting principles used, or when historical cost provides a better basis for valuation. Market values may be used if they provide a better basis of valuation than tax values or historical cost. Interest and dividend income must be grossed up to include resident withholding tax and imputation credits.

There are also presentation requirements that state the accounts must show:

- comparative figures for the prior income year,
- if the accounts are GST inclusive or exclusive,
- tax reconciliation to accounting profit,
- tax fixed asset register,
- reconciliation of shareholders equity for the year,
- relevant amounts from the financial statements summary (IR 10),
- notes to support any amounts disclosed as exception items on the IR 10.

In addition to the above requirements, specific disclosures are required for foresters, livestock owners, and transactions with associated persons.

These are a minimum set of requirements. A higher level of reporting can be adopted if required. The IRD will also accept accounts prepared under NZICA's special purpose framework.

In recent years the IRD has become more adept at collecting and analysing financial information for investigative purposes. Care needs to be taken to disclose the right level of financial information, but always put it through an IRD lens to ensure it is presented in the most favourable light. A misunderstanding by the IRD when reviewing information could lead to unnecessary and costly IRD scrutiny.

# Tax Payments – when received in time

Despite our best efforts, many of us are familiar with the consequences of making late tax payments to the IRD. Often, the problem is not just that we forget and leave it to the last minute, but that the payment we make is not processed or received by the IRD in time.


Late payment penalties and use-of-money interest can often be prevented by simply paying tax on time. The IRD has released an updated Standard Practice Statement (SPS 14/01) setting out when different types of tax payments will be accepted as having been paid by the due date. Importantly, it contains several amendments to the previous standards, particularly in relation to payments by post and payments made at Westpac. These changes took effect from 1 October 2014. To ensure your next tax payment is not late and subject to interest and penalties, it is important to familiarise yourself with the standards, as summarised below.

**Payments by post** – previously, the IRD based the payment date on the post date on the envelope. This is no longer the case. Instead, the IRD will deem the payment date to be the date the envelope is received. As a result, if your routine is to post the cheque on the due date, you may need to put it in the post a day or two earlier.

**Electronic payments** – payments made electronically or by direct credit into an IRD account must be completed before the end of the bank's online "business hours".

For example, if a GST payment is made on 28 April at 10.30pm but the bank's internet banking cut off is 10.00pm then the payment will not be processed that day and could be treated as late. This also applies to payments made from overseas (bearing in mind the international time difference).

**Physical delivery** – payments made by cheque must be delivered to an IRD office before it closes, by the due date.

**Cash & EFTPOS** – all cash and EFTPOS payments must be paid over the counter at a Westpac branch by the due date. It is important to note that returns must still be filed electronically, posted or delivered to the IRD (Westpac will accept the payment but not the actual tax return).

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**Post-dated cheques** – post-dated cheques will not be banked by the IRD until the specified date. If it is post-dated after the due date then it will be treated as a late payment (even if it was received before the due date).

Take note that from 1 October 2014, Westpac stopped accepting cheque payments so these must now go directly to the IRD.

**Weekends & public holidays** – if a due date falls on a weekend or a public holiday then electronic payments will be accepted on the next working day. This includes all provincial anniversary days.

Whatever your preferred method of payment, adhering to these updated and clarified standards will enable you to avoid unwanted interest and penalties.

# Business structuring

Whether you are starting a new business or looking at expanding your existing business, deciding on the commercial structure to adopt can seem daunting and the help of an advisor is likely to be sought. Irrespective of that help, the final decision will be made by you – based on your answers to the following types of questions.

What are you about to do? Is it a completely new venture or something similar to what you are doing now? Who are you going to do it with? How long are you going to do it for? Do you plan to exit and how? What is your propensity for financial and commercial risk? Where is the financing coming from and how much? Do you expect to make a loss before you make a profit? Will you have sole control or will it be shared? How will profits be split?

Taking into account some of these questions, attributes relating to some basic structuring options are provided below to help demystify why one option might be better suited than another.

**Sole trader** - without the benefit of limited liability protection, it is relatively rare to operate as an individual. However, if a business is small with little to no commercial risk, this might be a viable option.

Profits and losses are included in the person's tax return. This could be beneficial during start-up if losses are incurred because they will be offset against any other income.

**Company** - a company is a separate legal entity and provides limited liability to shareholders, subject to personal (or other) guarantees to company creditors. Companies are taxed at the company rate of 28%, which is less than the top personal tax rate and the trustee rate (33%). This provides a timing advantage, as the 33% rate won't apply until the company distributes its profits to its shareholders. However, capital gains can be trapped in a company because they are generally only able to be distributed tax free by liquidating the company.

If a company incurs a tax loss, it can only be carried forward or transferred to another company (subject to meeting criteria).

This is the most common structure used by New Zealand businesses. For this reason, they are well understood and easy to setup.

**Partnership** - a partnership arises where two parties carry on a business in common with a view to profit. Historically, partnerships were more common, for example doctors, lawyers, and 'husband and wife farmers' would generally operate in partnership.

A key downside of partnerships is that the partners are jointly and severally liable for the debts of the partnership. Hence, partnerships are typically only used in specific situations.

For GST purposes, the partnership is treated as a separate person, but for income tax purposes the assets, liabilities, income and expenses are attributed to the partner. These rules can be complex.

**Limited Partnership (LP)** - originally introduced to assist foreign investors wishing to invest in NZ ventures, they generally provide the benefit of tax transparency (as they are taxed as a partnership) combined with limited liability protection. LP's are generally only used in quite specific situations, such as land developments.

**Trust** - trusts can be flexible as income distributions are decided by the trustees. But their formation and governance are prescribed by a trust deed, which can lead to problems and disputes from a legal perspective. Trustees may be liable for the debts of the trust.

**Look Through Company (LTC)** - LTC's provide the benefit of tax transparency with limited liability protection. This enables losses (but also profits) to be included in the shareholder's tax returns and offset against other income. However, they are defined as partnerships for tax purposes and subject to quite specific LTC legislation, which can lead to compliance costs.

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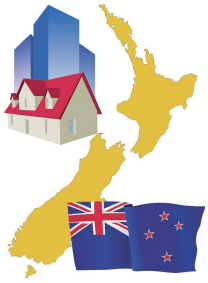
# Snippets

**Tax residency case overturned**

A recent Taxation Review Authority (TRA) case concluded an individual was a New Zealand tax resident despite being absent from New Zealand for a long period of time. In brief, the decision was a consequence of having an investment property that was 'available' to him in New Zealand and an on-going relationship with his family and ex-wife.



On appeal to the High Court, the TRA's decision has been overturned. The High Court held that the individual was not a New Zealand resident as he had never lived in the New Zealand investment property; therefore it could not be regarded as his 'home'. Although he did have other, on-going, personal connections with New Zealand, in the absence of having a 'home' or 'house' in New Zealand, these connections did not alter the conclusion reached.

This case provides a sigh of relief, as the original TRA decision was of some concern. Although every individual's situation is different, the High Court decision should give New Zealanders living and working overseas with an investment property in New Zealand some peace of mind.

**Drones reveal tax evasion**

Tax avoidance is a big problem for many governments around the world with some countries going to great lengths to identify and hold tax avoiders accountable. In particular, Argentina has started using drones to catch people who fail to declare certain items of property in their tax returns.

According to news reports, tax authorities have sent drones over wealthy areas of Argentina to investigate the existence of assets that owners may have failed to declare on their tax returns. The unmanned aircraft have taken pictures of at least 200 homes and 100 pools, all of which were sitting on plots registered as vacant. The drones' findings amounted to missing tax payments of more than US$2m (NZ$2.55m) with owners of the properties now expecting heavy fines.

Could New Zealand be next to catch on to this trend?

*If you have any questions about the newsletter items, please contact us, we are here to help.*

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