WINSTANLEY KERRIDGE
CHARTERED ACCOUNTANTS LIMITED

22 Scott Street
Blenheim
03 578 0180
www.winkerr.co.nz

Newsletter August 2010

Since our last general newsletter in March we have had the budget, the commencement of the ETS and some more Court decisions on what constitutes tax avoidance. The legislation for some of the changes announced in the budget has yet to be finalised. What we have attempted to do below is identify the winners and losers from the above.

The Losers (we start with them as unfortunately they will be the majority)

- If you own rental property the budget was **BAD NEWS**. For residential landlords the scrapping of depreciation on the dwelling is, for most, not too serious. However, the review of the ability of commercial landlords to depreciate fit-out will have a serious effect on cash flow if that is also scrapped.
- If you operate your business via a trading trust the Court cases are **BAD NEWS.**
- If you have been using a trust/company structure to maximise entitlements to Working for Families and Student Allowances for your children, the budget is **VERY BAD NEWS.**
- If you trade via a Loss Attributing Qualifying Company (LAQC) the budget is **VERY BAD NEWS**. The legislation has yet to be finalised. Once it is we will report to all persons owning shares in LAQC's with our recommendation as to whether or not the company should remain a LAQC.
- If you have borrowed money the combination of the introduction of the ETS and increase in the GST rate is **BAD NEWS**. With the Reserve Bank having to allow for government imposed cost increases in its inflation targets, nothing is surer than these changes will result in interest rate rises.
- If you have borrowed money and are an exporter the changes are **VERY BAD NEWS** as higher interest rates generally translate to a higher Kiwi dollar.
- If you are buying new fixed assets the budget is **BAD NEWS** as the 20% depreciation loading on new assets has been scrapped for all assets purchased after 20 May 2010.
- The announcement of an extra $120m for IRD audit activity over the net years. **GOOD NEWS** for accountants but **BAD NEWS** for everyone else, especially property owners as that is a target area.

The Winners (there are some)

- If you are a lender/investor and not a borrower, **GOOD NEWS** as interest rates on investments will rise.
- If you are importing goods into NZ, **GOOD NEWS** if the higher interest rates keep the Kiwi dollar high. In theory, this should help retailers as long as people have any money left to spend.
- If you don't spend all your income, **GOOD NEWS** as the drop in income tax rates should more than offset the increase in GST.
- If you own post 1990 exotic forest the confirmation of the ETS scheme is **VERY GOOD NEWS**. The scheme provides you with 2 possible income streams from your forestry, although selling carbon credits does create risks if the trees are sold or destroyed.

  A couple of quick reminders on the sale of carbon credits:

  a) the proceeds <u>are not</u> liable for GST (and you can not claim GST on carbon credits purchased);

  b) the proceeds <u>are</u> liable to income tax.
- If you are one of these people who believe the rich shouldn't be getting Working for Families handouts, student allowances etc, the budget is **VERY GOOD NEWS**. However when we have a welfare system where the government plays Father Xmas by dishing out billions of dollars in welfare credits, rather than lowering tax rates, who can blame the rich for organising their business structure to get their share.

Picton Office

We no longer maintain a full time office in Picton. However Craig Forsyth will visit Picton Wednesday mornings, as required, by appointment. Please ring reception to make an appointment.

The new office is still located upstairs in Mariners Mall.

Withholding Tax and Farmers/Grape Growers

Another **BAD NEWS / VERY BAD NEWS** story.

In case you aren't aware, the rules changed (yet again!) on 1 April 2010.

The rules now are as follows:

If you directly hire any type of contractor (individual, partnership, trust or company) for work or services for the supply of labour, or substantially for the supply of labour on land in connection with:

- fruit crops
- orchards
- vegetables, or
- vineyards

you'll need to deduct tax from the contractor's payments at the rate of 15 cents in the dollar unless the contractor has a certificate of exemption or a certificate authorising tax be deducted at a special rate.

Unfortunately (and typically) the IRD haven't defined what "substantially for the supply of labour" means. The IRD guide book IR 635 uses the words, *substantial, incidental and most*, in various places. All of which is useless.

We have sought further clarification from the IRD as to what they mean.

Below are their comments:

MECHANICAL (no need to deduct withholding tax)

- mowing
- spraying
- machine harvesting
- machine stripping
- putting out nets using tractor and 2 or 3 men, of whom 1 is tractor driver - IRD accept that in that case labour content could be as high as 30 to 40%.

In general if machine is essential to the job it is mechanical but use common sense.

LABOUR (have to deduct withholding tax)

- hand pruning
- hand harvesting
- bud rubbing
- tying down

They confirmed it is okay to issue separate invoices for the mechanical and labour component of the cost, as long as cost breakdown is realistic.

And now the **SERIOUSLY BAD NEWS**. Later this year the IRD are intending to carry out audits of any contractor with lower than average profit margins.

If the contractor audited is one you have paid and you have failed to deduct Withholding Tax, **you are in trouble.**

Not only will you have to pay the Withholding Tax not deducted, plus late payment penalties, plus Use of Money Interest, but also you face the possibility of a substantial fine.

If you are employing a Contractor and they don't have an exemption certificate, deduct 15% unless you are certain the invoice is not substantially for the supply of labour (and even then, only if the contractor is a company).

For all other work done on land, other than that specified above, **if the Contractor is an Individual or Partnership <u>you must always deduct 15% Withholding Tax</u> unless they have an exemption certificate.**

If the Contractor has an exemption certificate make sure it is current, copy it and either file in a central place or attach to the invoice.

For this other, non specified, work you do not need to deduct withholdng tax if the contractor is a company.

PIE Tax Rates

The new PIE rates applying from 1 October 2010 and new marginal tax rates applying from 1 April 2011 are:

Taxable Income $	Combined taxable and PIE income $	Marginal tax rates from 1 April 2011*	PIE tax rates from 1 October 2010
0-14,000	0-14,000	10.5%	10.5%
0-14,000	0-48,000	17.5%	10.5%
14,001- 48,000	14,001 - 70,000	30%	17.5%
48,001 - 70,000	48,000-70,000	30%	28%
Over 70,000	Over 70,000	33%	28%
* Composite (average) rates apply for the current year			

As is clear from the table, the top PIE tax rate will be 28% whereas many investors will pay tax at 33% and 30% on direct investments. From 1 October 2010 investors on a marginal tax rate of 30% can be taxed on PIE income at 17.5% (a reduction of 12.5%) and investors on a marginal tax rate of 17.5% can be taxed on PIE income at 10.5% (a reduction of 7%).

PIEs remain attractive for top tax rate investors. There is still a 5% difference in the top marginal rate of 33% and the top PIE rate of 28%. The new PIEs rates make PIE investments more attractive to investors on the lower tax rates.

Changes to Employment Law

In July 2010 the government announced that it will be making changes to The Employment Relations Act and also, to the Holidays Act. The relevant changes are outlined below.

Employment Relations Act:

- Employers will be required to provide employees with a written (signed or unsigned) copy of their employment contract. Remember - it is already mandatory for all employees to have an Employment Contract. **Employers will be able to be fined for not providing a written contract to their employees.**
- The 90 day grievance free Trial Period will be extended to all businesses irrespective of size. Previously only employers with fewer than 20 staff were eligible.
- Reinstatement as a remedy in dismissal cases will be retained but will stop being the primary remedy as it often isn't practicable.
- A Code of Employment Practice is to be drawn up for managing dismissals and other personal grievances. The Code will require the approval of the Minister of Labour.
- Penalties for breaches of the Act will increase to $10,000 for individuals and $20,000 for companies.
- The Act will be amended to provide that union access to work places is conditional on the consent of the employer (but consent cannot be unreasonably withheld).

Holidays Act

There are no changes to entitlements, however:

- Employees will have the right to request their employer to cash up one week of their four week annual leave entitlement each year.
- Employers can refuse this request if they wish to, but they cannot require/request employees to cash up leave. This will be strictly an employee's prerogative.
- The value of the cashed up leave will be the same as it would have been if the employee had physically taken the leave.
- Holiday pay for Public Holidays, Sick and Bereavement Leave will be calculated on their "average daily pay"- the daily value of their gross earnings over the twelve months prior to taking the leave.
- Employers/employees will be able to agree to transfer the observance of one of the statutory public holidays to another day as long as it doesn't disadvantage the employee. Alternative holidays will now be taken at times agreed between the employer and employee. If agreement can't be reached the employer can decide.
- Employers will not have to wait for 3 days before asking for proof of sickness from employees. They will however, have to pay the costs of medical appointments that employees need in order to provide proof.

ACC Changes

Once again **GOOD NEWS** and **BAD NEWS.**

First the **GOOD NEWS** as for once it is a winner.

i) Taxpayers on CoverPlus Extra can apply for different classifications for each shareholder employee. e.g. If the company is a builder and one shareholder does all the clerical work and no building, that shareholder will be able to use the Clerical classification instead of the Building classification. This change applies retrospectively for up to 4 years. To apply go to the ACC website *www.acc.co.nz* and download form ACC 5474. A separate form has to be completed for each year you want to reassess.

We have always said, all self employed persons/ shareholder employees should be on CoverPlus Extra. If it was a no brainer before, this change makes it a double no brainer, especially for persons subject to high levies.

ii) Businesses in certain high risk categories, including farming and aquaculture, can get a 10% discount in levies by attending a Health & Safety course run by ACC.

iii) Now the **BAD NEWS.** The dreaded residual claim levy which was due to expire in 2013 has been extended to 2019. This levy basically covers prior year ACC underfunding (read inefficiencies). Wouldn't every business love to be able to charge its customers an extra fee for 20 years to make up for past lack of profit.

iv) Not a change, but something to watch out for. Every year ACC re-set every self employed person as being a Full Time worker - work more than 30 hours a week on average throughout the year. If this does not apply to you and you get an invoice from ACC contact them (or us) and advise ACC you only work Part-Time.

Fishing Quota Holders - ETS

If you own fishing quota you should have received an application form to apply for emissions units. These are allocated free to quota holders as compensation for any loss in value of their quota as a result of increase in the cost of fuel due to the ETS.

Applications were supposed to have been lodged by 31 July 2010. If you haven't lodged your application you need to check urgently if it is worth applying. For small quota holders the costs may exceed the benefits.

GST - Change in Rate

You should already have received from us, a newsletter summarising the main impacts of the change in the GST rate.

We now have available a more comprehensive guide on the effect of the change. If you would like a free copy please contact reception.

If you require assistance with handling the effect of the change on your accounting system, please contact Pat Bright, Jackie Baker or James Galloway.

Eleven Reasons Why You Should Talk to Your Accountant NOW

- To identify strengths and weaknesses in your business.
- To analyse the financial impact of decisions before making them.
- To get a health check of current and future financial position.
- To look for ways to improve cash flow and bottom line profitability.
- To predict possible tax liabilities before the end of the financial year.
- To plot the future direction of your business in a manner that can be effectively monitored.
- To create projections, discover solutions and avert possible disasters.
- To determine whether the next $100 of sales have a positive or negative cash flow effect.
- To improve your financial literacy skills and help you to make better business decisions.
- To understand how accountants, banks and other businesses measure performance.
- See your accountant for advice, tips and ideas on how to go forward.

Measuring Business Performance with KPI's

These days you need more than a set of financials to accurately measure business performance.

Today business owners and financiers are demanding more effective performance measuring systems that will not only enhance their performance levels, but also give them that all important competitive edge.

The traditional statement of financial performance, statement of assets and liabilities, and so on, is great for providing the financial information.

But what they don't do is link operational performance to the business's strategic objectives.

Performance needs to be judged against objective criteria.

This is where KPI's come in - Key Performance Indicators. KPI's are those critical measures which ultimately determine profitability and shareholder value.

KPI's are essentially a method of measuring business objectives against performance.

They tell businesses, amongst other things:

- How well they provide services
- How long they take to process customer requests
- Their product delivery performance
- How much time they spend fixing mistakes.

Most small businesses would benefit from improving performance measurement standards, and while there are different views on how this should be achieved, one point is clear.

No single measure can provide a clear picture of a business.

The complexity of managing a business today requires managers to be able to view performance in several areas.

Understanding Key Performance Indicators will greatly assist in finding out the financial health of your business, identify the critical strengths and weaknesses and evaluate the impact of future business strategies.