



GST increase – is your business ready?

The Government has all but confirmed that the GST rate will increase to 15%. The rate increase could apply as early as October 2010.

A rate change will have wide implications. It is not simply a case of changing the rate in the accounting system. Tax rate changes also bring about changes to consumer behaviour and put pressure on price margins.

A few points to consider:

- Attention to pricing expressions in the contract will be vital. If the price is expressed as "plus GST" or similar, the supplier has the right to increase the amount of GST charged to reflect the new rate. For this reason, we recommend using "plus GST" in all contractual pricing expressions.
- Experience from the last increase in 1989 suggests consumer spending will increase prior to a GST rate rise especially for "big ticket" items. Businesses need to be ready for the potentially increased demand leading up to the rate change and also plan for possible decreased sales following the increase. Such fluctuations in turnover can have other repercussions such as provisional tax payment planning.
- The timing of entry into, as well as funding of, supply contracts will be very important.
- There may be commercial opportunities to alter pricing models and encourage consumers to pay 'up front' for recurring and ongoing supplies creating cash flow advantages for businesses.
- When a rate change occurs partway through a taxpayer's return period, two

GST returns are required to be filed. This may be relevant for taxpayers filing two or six monthly depending on the financial year alignment (i.e. those tax payers who do not have a 31 March financial year).

There will also be a change in the GST fraction; for a 15% rate, the GST component can be calculated by either multiplying the GST inclusive amount by the fraction 3/23 or by dividing by 7.6 recurring.

Potential Reporting System Issues

Accounting and reporting systems will most likely require changes to accommodate the new rate of GST.

Changing the default GST rate in the system may result in the change being applied retrospectively, causing problems with reconciliations.

Accounts Payable (AP) systems will need to be able to operate two different GST rate codes simultaneously given invoices with old and new GST rates may be processed for some time after the GST rate change has occurred. An alternative is for the system to allow AP staff to override the GST calculated by the system with the correct amount.

Also care will be required with those using spreadsheets for reporting and return preparation to ensure calculations that involve GST have been correctly updated.

There are likely to be many other issues arising – consideration of these potential issues should be thought about now to minimise the impact on business operations.

For specific industries

- Exporters may have to carry a greater working capital cost as GST costs must be funded until the relevant return has been filed and the GST refund paid out (as the GST cost is unlikely to be funded from an increase in GST collected on sales).
- For importers, an increase in the GST rate will result in a higher GST liability for imported goods. Importers utilising the NZ Customs Deferred Payment Scheme for import GST should consider applying for an increase in the allowed credit limit.
- The farming sector should consider the wording around payment for supply contracts and pricing.
- Land and property developers should ensure all agreements entered into are on a "plus GST" basis so that the price can be increased to take into account a new GST rate. On the other hand, private purchasers may wish to lock GST in at the lower rate. Care is required to ensure deposit amounts charged after the rate increase cover any increased upfront GST liability on sales.
- For retailers, any projected GST rate increase is likely to drive consumer spending in the months leading up to the change. Opportunities may be created; e.g. consumers may wish to lock in HP arrangements at the old GST rate.

We will certainly keep you abreast of the changes as more details are published. If you have any concerns, please do contact us.

Checklist

While not exhaustive, we have listed below a few points that all businesses should reflect upon:

- Can we increase the price charged to customers to cover a rate increase?
- What changes do we need to make to our accounting & reporting systems?
- Are we prepared to maximise opportunities arising from any increased consumer activity leading up to the rate change?
- Will a GST rate increase affect our funding position or cost base?
- Is our GST compliance position robust given the potential exposure the rate change represents?
- Can our systems issue correct tax invoices, as well as debit and credit notes at both the 'old' and 'new' rates?
- Can our AP system process tax invoices at both rates?

DANIEL MARTIN VIRTUE

11 December 1936-13 February 2010



Dan, or as he was respectfully known by many of the staff of Blackmore Virtue & Owens, Mr Virtue, was born in Fiji. He moved to New Zealand where he attended Mt Albert Grammar School and Auckland University.

After graduating with a Bachelor of Commerce he commenced his professional training in 1955 with Barr Burgess & Stewart (today PriceWaterhouseCoopers) before joining his aunt, Doris Hearne, at Blackmore Hearne in Broadway Chambers, Newmarket, then Remuera Road for some years until the firm moved to the current site in Newmarket. The firm became Blackmore Hearne & Virtue in 1960 when Dan was made a partner and subsequently changed to Blackmore Virtue & Owens in 1997.

During his career, Dan was a director of four publicly listed companies and continued to be a Director of some significant private companies. He was also a Trustee, Board member and Chairman of significant not for profit community groups. Dan developed an interest in business valuations and became an authority in this area and was often called upon as an expert witness in many business court disputes including appearing before a tribunal established by the Privy Council to settle a long running business valuation dispute.

He had a wealth of business and accounting knowledge and had explicit views on many subjects - for instance, that rugby is vastly superior to soccer. He was very difficult to argue with as he had such definite opinions and could put together a very strong case on many subjects. He was widely read, interested in music and politics, and was a perfectionist when it came to accuracy. His knowledge of grammar, spelling and punctuation were part of his drive for perfection.

As well as these attributes he was very family oriented, caring, compassionate and generous.

Clients have shown their confidence in, and loyalty to, Dan. A client who recently passed away, had been a client for 50 years. Many others have valued Dan's knowledge, integrity and invaluable help with their businesses and financial affairs and this is shown in the number of clients who have remained with Dan for over twenty years and who have become close friends.

Dan was a creature of habit, rising early most mornings to exercise in his home gym, playing tennis at the Remuera Tennis Club on Wednesdays, playing golf or tennis at weekends and having the same tuna and salad for lunch every day at the office after his cardiologist told him that tuna was good for his heart.

Later in life Dan had some health problems, including cardiac surgery, eye surgery, knee replacement and skin cancers but few people knew of the leukaemia that he lived with for many years and which finally was too much for him. A very private person, Dan returned from holiday after Christmas and told his staff that he had a minor liver problem that required surgery and he would be back at work in a few days. Sadly however his condition worsened and three weeks later he passed away.

Blackmore Virtue & Owens, the firm that he has led for so many years, will be a different place without him but he leaves it with loyal partners and staff, some of whom have been there for twenty years and others who have left and then returned years later. We will endeavour to ensure that his legacy of accuracy, integrity and loyalty continues.

Dan is survived by Jude his wife of nearly fifty years, his son Greg, two daughters Bronwyn and Philippa, and four grandchildren.

Sadly gone but never forgotten.

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BLACKMORE VIRTUE & OWENS

Your Chartered Accountants and Business Advisors

Level 2, 18 Broadway, Newmarket, Auckland, PO Box 9579, Newmarket, Auckland 1149, New Zealand
Telephone: +64-9-520 4089 Facsimile +64-9-524 7580

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advisor



Level 2, 18 Broadway, Newmarket, Auckland 1023
PO Box 9579, Newmarket, Auckland 1149, New Zealand
Tel: 00-64-9-520 4089, Fax: 00-64-9-524 7580, Email: bvo@bvo.co.nz

Tax reforms

In late January 2010, the Tax Working Group released its final report to Government. There has been much publicity about the proposed changes and we can be sure that in the May 2010 Budget significant tax reform measures will be introduced.

Tax reforms – likely changes ahead
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So what can we expect or anticipate? It appears almost certain that the GST rate will increase to 15%, with a likely implementation date of 1 October 2010. We discuss the business issues that may arise later in this newsletter.

To “lessen” the impact this will have on consumers' wallets, changes to personal and corporate tax rates have already been foreshadowed.

For individuals, the marginal income tax rates for low to medium income earners should reduce the impact of the GST increase and the highest personal tax rate may be aligned with the trustee tax rate of 33%.

For companies, any changes to the tax rate from 30% will most likely follow whatever our Trans-Tasman cousins decide following the release of the Henry Review. Certainly, if NZ is to encourage corporate investment, the rate will need to be in line with our major trading partners, with the international trend being to reduce corporate tax rates.

The most significant changes will impact on NZ'ers love affair with real estate ownership. It is suggested that any reforms will be around limiting depreciation of residential rental buildings, removing the 20% step-up on other depreciable property and possibly quarantining losses incurred on residential rental properties. Are we going back to the mid 1980's?

Any such proposals to the tax treatment of residential rental properties would need to be tempered by the economic flow-on effect that such changes may bring. One can foresee many investors facing mortgagee proceedings should the depreciation allowance be removed.

However, perhaps such reforms will also address the imbalance of the residential property market and reflect the true economic value in that sector.

We will continue to provide updates on any tax reform proposals as they are announced.

Revisiting your tax filing positions

The Inland Revenue has been rather successful of late in recent tax avoidance cases. In the past two months, three Taxation Review Authority Decisions ("TRA") have been released involving small business taxpayers in which the Commissioner has alleged tax avoidance. So far, the Commissioner is ahead of the "game" leading 2-1.

The facts of each case differ but the Commissioner's arguments have been similar. In brief, he has argued that:

- the arrangement in question cannot be explained in terms of ordinary commercial purposes and can be explained only in terms of a concocted series of steps aimed at obtaining a tax benefit;
- the mechanism used to achieve the results was contrived and artificial and lacked economic substance; and
- the 2008 decision in *Ben Nevi Forestry Ventures & Others v CIR* was effectively that transactions that are tax driven tend to be artificial and contrived as they are not focused on the commercial realities. If the taxpayer uses a specific provision in the Income Tax Act in an arrangement that has no commercial purpose, Parliament would not have contemplated such a use.

Following the High Court Decisions late last year on tax avoidance (*Penny & Hooper*, *BNZ Investments Ltd* and *Westpac Banking Corporation Limited*) there has been considerable

interest in how the lower courts apply the Supreme Courts decision in *Ben Nevis*, particularly how the courts would apply the Parliamentary contemplation test that forms a central plank of that decision.

In one case, TRA No. 03/08, Decision No. 3/2010, the facts were a property developer received a series of loans (mostly from trusts) over a 12 year period, while at the same time drawing only a small salary. The trading entities themselves operated in a way that virtually no tax was payable, as the income from one project was generally offset by the costs of the next project.

Notwithstanding that the underlying trading entities did not derive taxable income; the TRA found that the receipt of the loans by the taxpayer and held on "loose" terms, rather than a salary, amounted to tax avoidance.

The taxpayer had repaid part of the loans out of capital distributions from the entities. On this point the TRA commented that the Commissioner was generous only assessing the net balance of the loans.

Looking Good!

Yes we made the big decision!

You'll see from our new logo on this newsletter that we have taken the bold step to revitalise our whole branding.

The decision to refurbish the offices prompted the brand review and we have spent many months working alongside Critical Mass Communications to develop our new brand graphics, style and all supporting materials.

Already we have builders tearing down walls, erecting new ones and redesigning our offices to match the new modern look.

Exciting times! And once completed, we look forward to showing all of you around our new offices.

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Snippets

Year end tax planning

With 31 March just around the corner it is time to think about maximising opportunities and minimising risks as part of successfully managing your tax position.

Certain issues need to be dealt with prior to 31 March (or the company's balance date) before it is too late.

We have summarised below a few of the key areas that should be reviewed NOW:

Imputation credit accounts must be considered prior to 31 March regardless of the company's balance date to ensure:

- That the balance is in credit otherwise a penalty will be applied
- 31 March 2010 is the last date dividends can be paid utilising the ratio of 33/67.
- A check should be made to ensure the company has not attached more credits at the 33/67 ratio than it had available, or a penalty may arise regardless of whether the balance is in credit.
- If there have been or will be changes to the ultimate shareholders in the company please contact us immediately.

Bad debts must be physically written off in the accounting records within the financial year.

- Consider whether there are any doubtful debts that could be regarded as 'bad' and written off before year end.
- Note that there may also be GST to claim back for debts written off.

Best practice is to check that provisional tax paid to date will reflect the 2010 year's result to maximise cash flow and minimise any use of money interest (current rate is 8.91% on underpayments).



The TRA also determined that a penalty for adopting an abusive tax position (100% of the tax shortfall being the base position) should be applied.

So what does this decision mean for taxpayers and tax advisors?

There are a number of aspects in the fact pattern that are very common in the Small to Medium Enterprise (SME) context:

- the non-payment of salaries to "owners" in the absence of taxable income in the trading entity
- drawing and living on capital gain amounts
- the use of current accounts within family structures to transfer money
- the use of journal entries to record movements in current accounts

Tax practitioners and other interested parties are awaiting the Court of Appeal decision of Penny and Hooper which will hopefully provide some certainty around how "owner/operator" businesses (which make up the majority of NZ businesses) can operate and where the avoid-

ance boundary arises rather than the current lottery of retrospective avoidance legislation.

So in the meantime...

Tax avoidance is no longer the domain of the largest corporates with complicated financial structures; these recent cases indicate that the avoidance question is becoming more mainstream amongst the SME market.

Practitioners and taxpayers in the SME market must reassess the filing position

traditionally adopted in light of the apparent shift in the tax avoidance boundary.

Understanding the potential risks and shifting boundaries as to what is an 'acceptable' tax position is paramount. Remember it is not if you will be audited, but rather when.

Please contact us if you have entered into any transactions during the year or if you are unsure of the tax position taken in earlier income years is robust to withstand such Inland Revenue scrutiny.

- Check that there are no nasty surprises such as unexpected exchange fluctuations which may require an estimate or a voluntary payment to be made prior to the last provisional tax instalment.
- Small businesses with seasonal or fluctuating income may wish to consider an election to use the GST ratio method for 2011. Use of money interest is avoided when this method is used. Elections would need to be made prior to the next income year; i.e. by 31 March 2010 if a March balance date.

Qualifying companies – have there been any changes to directors and shareholders during the year. Have the necessary elections been made to ensure the status is not revoked?

There have been recent changes to the thin capitalisation rules extending the interest deduction limitation to NZ companies with outbound interests in controlled foreign companies for income years commencing on or after 1 July 2009. Do you know if your company is impacted by these rules?

If you have doubts or concerns, please contact us.

Trustee distributions to beneficiaries

New legislation allows trusts to "allocate" income effectively up to 31 March following balance date.

However, note that most existing trust deeds stipulate that trust income must be paid out or applied during or within 6 months of the end of the income year.

Now is the time to review your trust deed to determine whether any changes should be made to facilitate the allocation of income to beneficiaries within the timeframe allowed by legislation and under the terms of the trust deed.

Reselling property purchased "off the plan"

Have you sold property purchases "off the plan"? Inland Revenue is targeting profits made on sales of properties resold before the contract to purchase becomes unconditional.

In a recently published booklet, Sold or thinking of selling property you purchased "off the plan"? IR 368, Inland Revenue outlines its view on the tax treatment of such transactions. According to Inland Revenue, if you sell property while the contract is still uncondition-

al, any gains made will be taxable no matter what your intention was when acquiring the property.

Inland Revenue's reasoning is that, if the contract is still unconditional, you can choose to cancel rather than sell the property.

This position is contentious and the New Zealand Institute of Chartered Accountants has said that Inland Revenue is providing "potentially misleading advice" to taxpayers and "it is unlikely that Parliament ever intended such transactions to be taxable".

Taxpayers in this position should seek professional advice rather than relying on such misdirected Inland Revenue comments which go completely against established case law.

If you have any concerns or have been contacted by IRD, please do contact us.





A tribute to Dan Virtue

Sadly, Dan Virtue passed away recently. Dan was an integral part of BVO and his loss is a great one. As a tribute to Dan, we have included with this Newsletter a brief account of his highly successful business career and life. We will all miss him very much and our thoughts are now with Jude and his family.

Last year, as part of Dan's future succession plan, he appointed Alex Houghton as a co-director with the intention that Alex share the workload as he moved towards retirement. Alex and Dan worked very closely together on all business matters which has given Alex a strong appreciation of the integrity and loyalty which Dan always showed his clients.

Alex will now take over full responsibility for Dan's clients and aim to provide the same outstanding service and dedication that Dan achieved.

Alex has broad experience in accounting, tax, audit and business advisory from smaller businesses to larger corporates. Prior to joining BVO, he was a tax manager at Ernst & Young working on a variety of clients from owner-operators to multinational companies and companies listed on the New Zealand stock exchange. While in the United Kingdom Alex held management accounting and systems roles in the European Regional Office of Walt Disney International, a financial analyst role at British Sky Broadcasting PLC and was an auditor at one of Ernst & Young's London offices. Before travelling to the United Kingdom, he worked as an auditor at Ernst & Young's Auckland office and at Grant Thornton.

Alex is supported by a strong and capable team and we are confident that he will ensure that Dan's legacy of accuracy, integrity and loyalty continues.

FBT returns – recent changes may equal opportunities

As you may be aware, there have been legislative and ruling changes that impact the calculation of FBT for the year to 31 March 2010. Being the final quarter of the 2010 FBT, it is timely to consider the options available for reducing FBT payable. This may include performing year-end attribution calculations and reviewing previous quarter returns.

Legislative changes

The following legislative changes which impact FBT for the year ended 31 March 2010 were:

- The FBT single rate dropped from 64% to 61%.
- The de minimus threshold for FBT on minor unclassified benefits has increased. FBT is only payable if the total taxable value of all unclassified benefits provided to an employee is more than \$300 quarter or the total taxable value of all unclassified benefits provided to all employees in the last four quarters including the current is more than \$22,500 (i.e. in effect this is a rolling calculation).
- The FBT annual return filing threshold has increased from \$100,000 to \$500,000 of payroll taxes. Elections into this option from the 2011 income year need to be made by 30 June 2010.

Generally, if FBT has been paid using the alternate rate option of 49% for each of the first three quarters, then a multi-rate attribution calculation will be required for the final quarter. If the single rate option of 61% has been chosen, then this rate is used for all four quarters, with the option to perform the multi rate attribution calculation in the March quarter.

Traditionally many businesses opt to calculate FBT using the single rate of 61% for all quarters for ease of compliance, however there may be considerable savings to be made by performing the multi rate attribution calculation. The final quarter return is not due for filing until 31 May 2010 which provides employers with more time to consider and complete the return using the best method.

Ruling changes

In November 2009, the Inland Revenue released a public ruling which clarified the definition of the "cost price of the vehicle". A significant change in this ruling is that the cost of sign writing the vehicle is no longer included as part of the cost of that vehicle as such costs are considered to be of a business nature.

The change was retrospective from 1 November 2008 and will in most instances provide a reduction to the cost price of a vehicle for FBT purposes. A review of whether

these costs have been included in the past quarters should be undertaken as FBT may have been overpaid.

FBT reviews

A review of FBT can pay off in terms of reducing risk and increasing savings. Common areas of misunderstanding include:

- Not picking up all unclassified benefits such as gifts, vouchers and not understanding how the de minimus rule applies.
- Lack of supporting paperwork surrounding pool cars which are taken home.
- Lack of awareness around options for pooling fringe benefits and how to minimise costs.

A review in this quarter provides a timely opportunity for your organisation to ensure that you are minimising your risks and maximising the opportunities.

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Please call us today to discuss,
Phone: 520 4089