

## April 2008

### Company Tax Rate Reduction

The reduction of the company tax rate to 30% from 1 April 2008 will make a company structure more attractive than it was previously.

Despite the obvious tax advantage, there can be pitfalls as well in changing an existing business structure to a company. The obvious ones are that:

- an extra 9 or 3 cents in the dollar will need to be paid at some stage when income is streamed down to shareholders at marginal tax rates of 39% or 33% respectively
- the possible liability for Fringe Benefit Tax and depreciation recovered on assets transferred into a company from a sole trader or partnership.

It is possible, this being election year, that there could be tax reform (cuts) announced this year. With this in mind it may be best to wait for the dust to settle later in the year before restructuring.

There are a number of transitional rules for existing companies. Some of these are listed below.

1. There is a transitional period ending on 31 March 2010 where companies can continue to pay dividends by attaching their pre-2008 tax-year imputation credits at 33%. We note that companies wishing to do this will need to keep records that clearly identify taxes paid at the 33% rate and taxes paid at the 30% rate. This is necessary for anti-avoidance rules where a company cannot pay dividends by attaching 33% imputation credits from imputation credits that arose at the 30% tax rate. A penalty tax of 10% will be payable where there are insufficient credits in the imputation credit accounts.
2. Companies will need to decide whether to declare a dividend to use their 33% imputation credits by 31 March 2010, which will mean an extra 6% tax liability for taxpayers at the 39% marginal rate or not

paying a dividend which could result in a 9% tax liability at some stage in the future (assuming the top marginal tax rate remains same).

3. Dividends declared **after 1 April 2008** with only a 30% imputation credit will require a 3% Withholding Tax top-up payment. Shareholder companies receiving dividends after 1 April 2008 with 33% imputation credits will only be able to apply 30% imputation credits when they pass these dividends on to their (individual or Trust) shareholders.
4. Another change is that the payment of Qualifying Company Election Tax will now create a credit to the imputation credit account. This is significant because Qualifying Companies and Loss Attributing Qualifying Companies are required to firstly clear all imputation credits with taxable dividends before any capital dividends can be made which are tax-free.

Nevertheless, many companies with individual shareholders may consider entering the Qualifying Company regime to allow for shareholding changes after 1 April 2008. Care is needed particularly if the Company has previously made a gain from a related party transaction.

### Graham & Dobson Phone Number

Just a reminder that Graham & Dobson's telephone number is 869 1234. This changed when we moved to our new premises almost 2 years ago. If you have our number stored in your phone memory, please check that you have the correct number.

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## Withholding Payment Regulations – confused?

In November 2007 Mohammad Wasim received a prison sentence of five years nine months for his role in what the Inland Revenue called the biggest horticultural industry tax fraud they had ever prosecuted. The scheme, carried out between 1 April 2004 and 31 October 2006, involved contractors evading their tax liabilities by claiming they subcontracted work to another company or having another company issue an invoice for work completed by their employees.

The horticultural industry has been the subject of considerable IRD scrutiny due to it historically being an easy target for tax evasion. The Withholding Payment Regulations (WPR) currently require tax to be deducted from payments made to fruit pickers (individuals and companies). However, prior to 1 April 2006 if these services were carried out by a company for an orchard owner, withholding tax did not have to be deducted. Due to this exemption, companies were setup to carry out the work, with no withholding tax being deducted from the income earned. The individuals who set up the companies simply walked away without the tax being paid. From 1 April 2006 the rules were changed specifically to counter this scenario. Withholding tax is now required to be deducted from payments to companies that carry out work of this nature.

The problem with the WPR is that they can be confusing, as they appear to overlap the PAYE rules. This makes it hard to distinguish whether a WPR tax code or a generic PAYE tax code should be used. The mechanism used by an employee to select the correct tax code is the Inland Revenue form, IR330. The form itself requires a WPR rate (withholding tax rate) to be used if a person is operating under a “contract for service” and “not for salary or wages”, but the form does not explain the distinction. The basis for the distinction lies in the difference between how employees are taxed versus the self employed. A person employed under a “contract of service” is an employee and their income is taxed through the withholding of PAYE by their employer. The self employed on the other hand are employed under a “contract for service” and are responsible for meeting their own tax obligations as they are required to calculate their income and expenses and file an income tax return.

Whether a WPR rate or a generic PAYE rate applies will depend on the circumstances under which the person is to work. The WPR are not relevant if a person is an employee, ie the person is employed under a “contract of service”.

Indications that a person is an employee include an entitlement to annual and sick leave, having set working hours, no financial risk, and having a high level of control by their “employer”. If a person is an employee and therefore is receiving a salary or a wage, the WPR do not apply and the generic PAYE rates are followed. If a person is self-employed the WPR apply and withholding tax must be deducted at the rate specified on the IR330.



## Your Business – a Goldmine or a Coffin

There are about 325,000 small to medium sized enterprises (SMEs) in New Zealand. That’s over 96% of the country’s total number of businesses.

The average age of business owners in New Zealand is 58 years old. Forty percent of them plan to sell their business in the next five years. That’s about 130,000 businesses on the block during that period. Most of them won’t stand up to a great deal of scrutiny. However, some could be potential gold mines for the right purchaser.

So what are the options for small business owners who want to fund their retirement by exiting their business?

To be frank, there are not many. They include:

- prepare it for sale to another business or would-be business owner;
- transfer it to the next generation of the family;
- sell it to the employees of the company;
- liquidate the assets of the business, or
- sell the shares to the public.

A lot of small business owners hope to have a family member take over on their retirement. In practice we find that children increasingly have no interest in taking over the family business.

The key to planning for succession is to grow the business so that it is less dependent on the owner and more attractive for sale.

For buyers there are a number of considerations.

It is important to have a good understanding of what you are buying. This can only be determined by adhering to a properly structured due diligence process. Due diligence is a term for a number of concepts involving either the performance of an investigation of a business or person, or the performance of an act with a certain standard of care.

External advisors can help to make sure that the process is not hijacked by a desire to complete the purchase.

Small businesses often depend on the owner's commitment, contacts and history. The challenge the purchaser faces is to make sure the goodwill they have paid for sticks to the business in the future.

Businesses looking for new acquisition opportunities should look for potential acquisitions closely aligned to their core competencies and to which they can add value following the purchase. Follow the old maxim – "stick to your knitting". Once they have selected the target they should follow the right process. That means putting the right team together to work through the due diligence process.

Trends of market convergence, the age of many business owners and difficult market conditions mean that many businesses will be on the market over the next five years.

For prospective business owners, who follow the right process, there will be some nuggets out there.



## Livestock National Standard Cost Values 2008

The 2008 national standard cost figures (published recently) make quite interesting reading. NSC figures for sheep and beef cattle have decreased by about 7 or 8% compared to the previous year.

It's always hard to understand NSC figures actually going down when we know that all on farm costs are going up.

But while the cost of individual farm expenditure items may be increasing in percentage terms, the actual amount of spending on sheep and beef farms has been forced down because our sheep and beef farmers have not had the cash to spend.

The national standard cost calculation methodology is based on "*partial absorption costing*". Put simply, that costing method picks up only **some** of the farm operating costs (ie those costs that relate directly to breeding, rearing and growing livestock) and then divides that total pool of costs by the number of animals bred and reared on the farm. From 2006-07 to 2007-08 partial absorption costs on sheep and beef farms decreased by 7.8%.

## Drought Help

The financial consequences from the district's back to back autumn droughts will be of concern to a number of our farming clients.

We would like to do our bit and are happy to come to your place and "chew the fat" on the issues and options you have.

The best part is that visits to clients are free!

## Newsletters via the website

In future, we would prefer to send an e-mail to clients advising that our latest newsletter is on our website. We consider this to be a more efficient and cost effective way of getting the newsletter to you.

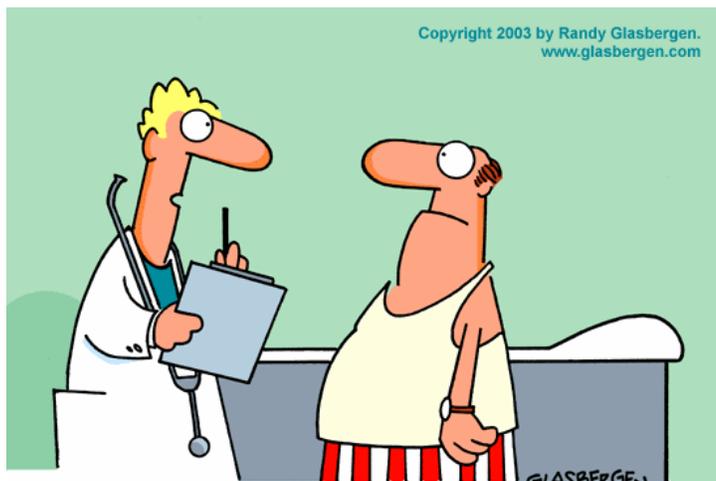
If you would like to receive future newsletters by e-mail, please go to our website at [www.grahamdobson.co.nz](http://www.grahamdobson.co.nz), click on the "Register for Newsletter" icon and complete the registration screen.



## Graham & Dobson Pens

If you have a Graham & Dobson pen that requires a refill, please see Wendy at reception for a free refill.

## Light Humour



**“What fits your busy schedule better, exercising one hour a day or being dead 24 hours a day?”**

### Jump School

At a jump school, a parachute instructor was discussing the sequence of events to expect should an emergency occur. "If you jump and for some reason your chute doesn't open, there is a reserve chute for that very purpose". "But suppose," asked an anxious member of the class, "the reserve chute also fails to open?" "In that case," said the instructor, "we have a situation known as jumping to a conclusion....."

### The Half-Wit

A man owned a small farm near Gisborne.

The Department of Labour claimed that he was not paying proper wages to his workers and sent out an agent to interview him.

"I need a list of your employees and how much you pay them", demanded the agent.

"Well" replied the farmer, "there's my farm hand who's been with me for three years. I pay him \$550 a week plus free room and board. The cook has been here for 18 months and I pay her \$500 per week plus free room and board.

Then there's the half-wit who works about 18 hours every day and does about 90% of the work around here. He makes about \$100 per week, pays his own room and board and usually I buy him a bottle of bourbon every Saturday night. He also sleeps occasionally with my wife."

"That's the guy I want to talk to – the half-wit," demanded the agent.

"That's simple," replied the farmer, "you are already talking to him!"

### Irish Medical Dictionary

Artery	The study of paintings
Bacteria	Back door to cafeteria
Barium	What doctors do when patients die
Benign	What you be, after you be eight
Caesarean Section	A neighbourhood in Rome
Catscan	Searching for Kitty
Cauterize	Made eye contact with her
Colic	A sheep dog
Coma	A punctuation mark
Dilate	To live long
Enema	Not a friend
Fester	Quicker than someone else
Fibula	A small lie
Impotent	Distinguished, well known
Labour Pain	Getting hurt at work
Medical Staff	A Doctor's cane
Morbid	A higher offer
Nitrates	Cheaper than day rates
Node	I knew it
Outpatient	A person who has fainted
Pelvis	Cousin to Elvis
Post Operative	A letter carrier
Recovery Room	Place to do upholstery
Rectum	Nearly killed him
Secretion	Hiding something
Seizure	Roman emperor
Tablet	A small table
Terminal Illness	Getting sick at the airport
Tumour	One plus one more
Urine	Opposite of you're out
2xCondoms	To be sure, to be sure

