

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 the 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 before 31 March 2008 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.

Research and Development tax credits

What is it?

From 1 April 2008, businesses will get 15% of tax credits on Research and Development (R&D) expenditure provided they satisfy a number of criteria. Currently, businesses are able to claim valid R&D expenses but, in addition they will also be able to obtain 15 cents as tax credits for every \$1 of "eligible" R&D expenditure.

Eligibility

To be able to claim the tax credits, R&D expenditure has to be eligible. Some of the criteria to be eligible include as follows:

1. The business must be carried on in New Zealand through a fixed establishment in New Zealand.

2. The R&D activities must be related to the business, that is, the entity must control the project and own the results of the R&D activities.
3. R&D activities can be both “core” and “supporting” R&D.

Core activities are systematic, investigative and experimental activities that will result in either seeking to resolve a scientific/technological uncertainty or a new/improved product.

Supporting activities are those that are commensurate with or integral to the carrying out of core activities.

4. The R&D expenditure must be tax deductible and must be \$20,000 or more for an income year.
5. Where R&D is conducted overseas, it has to be part of a New Zealand project and the R&D costs are limited to 10% of the total project costs.
6. Example of deductible costs that may be claimed for an R&D project are:
 - R&D salaries;
 - training, recruitment, relocation, and travel;
 - consumables; and
 - depreciation on tangible property.

Expenditure that is not eligible for the tax credits are:

- interest or other financing costs;
- acquisition of core technology or intangible assets;
- development costs exceeding \$2 million for in-house software to use internally;
- cost of R&D conducted overseas (except for the 10% allocation as above);
- costs covered by Government grants; and
- professional fees incurred in determining whether the R&D expenditure is eligible.

Core R&D

The aim of the New Zealand Government is to encourage New Zealand businesses to invest in R&D, as it believes there are wider benefits in the form of spill-over improved productivity and international competitiveness. At the same time, it also has to provide protection against claiming tax credits for excessive input costs for R&D expenditure where it is marginal or to prevent businesses claiming tax credits for the same R&D twice termed “double dipping” – this is when R&D is commissioned and performed by several different parties but the benefit is received by only one party.

An example of “double dipping” can occur with the cost of purchasing core technology such as intellectual property or prototypes where they are used for further R&D activities. The party selling the core technology may have originally claimed R&D tax credits and so the cost of acquiring it is an ineligible cost.

Activities that maybe R&D but are excluded from core R&D for tax credits purposes are:

- prospecting, exploring, or drilling for resources;
- quality control or making cosmetic changes;
- commercial, legal, and administrative aspects of patenting and licensing; and
- research in social sciences, arts and humanities.

How to claim it?

The 15% tax credit can be claimed by a business in its income tax return by filing a supporting statement (detailing the R&D projects) with the tax return by the normal filing date.

The tax liability of the business will be reduced by the R&D tax credits and if the R&D credit is in excess, then the surplus will be refunded by the Inland Revenue Department (IRD).

It is therefore important that businesses wanting to claim R&D tax credits establish a proper process where the R&D project is planned, systematic, and logical with a relevant documentary trail to support the statement filed with the IRD.

Note that the foregoing is not in force yet and the IRD has indicated that it will undertake further work to check eligibility of some expenditure once the regime is in operation. The above is only information that is open to interpretation and we strongly advise you to contact your tax advisor for details.

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End-of-year tax information checklist

It's that time of the year again when you'll need to start gathering together your accounting and tax information for the year ended 31 March 2008.

Set out below is a list of items that will assist you with this process, and remind you of some of your tax obligations.

Penalties regime

There is a mandatory 'shortfall' penalties regime in place – the penalties range from 20-150%. These penalties cannot be remitted.

Examples of where automatic penalties will be applied include when:

- Motor vehicle logbooks are not kept. (If you are self-employed, a logbook must be kept for a 3-month period every 3 years).

Please check that your work-related vehicles still meet the criteria, otherwise fringe benefit tax may be applicable.

- Stocksheets are not kept, or a stocktake is not physically taken.
- Bad debts are not physically written off before 31 March 2008.
- Withholding tax (usually 20%) is not deducted from subcontractors, unless they are operating as a company or have a certificate of exemption issued by Inland Revenue.
- Resident withholding tax on interest (19.5%, 33%, or 39% on election) is not deducted when paying interest of \$5,000 or more per annum to a non-financial institution/individual (unless a certificate of exemption is supplied).

This tax is usually due on the 20th of the following month.

Deductions

Deductible expenses may be claimed in the year in which they are incurred, even though payment may be made in the following year. Following are some special expenses which are either deductible in full or in part when they are incurred, but are related to the next income year.

The following expenses have no restrictions on the amount deductible:

- Stationery;
- Subscriptions to newspapers, journals, and other periodicals;
- Postage and courier costs;
- Rates;
- Road user charges; and
- Audit and accounting fees.

Advertising

Prepaid amount less than 6 months and under \$12,000.

Bad debts

To be deductible, bad debts **must** be written off **during** the income year. A mere provision or reserve is not deductible.

Consumable aids

Amount on hand under \$58,000.

Depreciation

- Taxpayers have the option of depreciating fixed assets on either a diminishing value or straight-line basis.
- Fixed assets can only be depreciated from the month of purchase, eg plant and machinery purchased on 25 March 2008 is depreciated for one month.
- Items costing up to \$500 (net of GST) may be written off in the year of purchase if certain criteria are met.

Disability/loss of profits insurance

Premiums are deductible in full where the taxpayers are in business on their own account, or are employees.

Discount reserve

A deduction for a discount reserve, such as a prompt payment discount reserve, is allowed if debtors are entitled to this discount.

In the first year, a deduction of 2.5% of the debtors' amount is allowed, and in subsequent years adjustments are made which maintain the discount level at 2.5% of the debtors' amount. If a higher discount is generally given, this could be used instead of the 2.5%.

Equipment service contracts or warranties

The full amount is deductible, provided it forms part of the consideration for the assets.

Holiday pay

The amount accrued at balance date is deductible, if paid within 63 days of the balance date.

Prepaid insurance premiums

Where the total insurance expense in the year does not exceed \$12,000, a 12-month prepayment is claimable.

Lease or bailment of livestock

Prepaid amount less than 6 months and under \$23,000.

Other services

Prepaid amount less than 6 months and under \$12,000.

Rent for land and buildings

Prepaid amount less than 6 months and under \$23,000.

Repairs and maintenance

Generally no deductions are allowed for a repairs and maintenance reserve, except for the periodic overhaul of business aircraft and the maintenance obligations of a construction firm under its building contracts.

Royalties

Royalties accrued to balance date are fully deductible.

Service or maintenance contracts

A prepayment of 3 months' expenses is deductible, provided the total expense on the contract does not exceed \$23,000 in the income year.

Subscriptions for trade professional associations

A prepayment of 12 months is deductible provided the total amount for that association in the year does not exceed \$6,000.

Telephone and other communication equipment expenses

A prepayment of 2 months is deductible.

Trading stock valuation

Don't forget to do a stocktake!

New stock and work-in-progress valuation rules were introduced from the 1998-99 income year, and have applied since.

The valuation methods differ depending on whether or not you are a 'small taxpayer'. Small taxpayers are those who, together with their associates, have an annual turnover of \$3m or less.

If the turnover is less than \$1.3m and a reasonable estimate of the true value of stock is made to be under \$5000, then a physical stockcount at year-end is not required and the opening stock value may be used.

Please contact us to establish the valuation rules that apply to your situation.

Travel and accommodation expenses

Prepaid amount less than 6 months and under \$12,000.

Income

Review credit notes in the months following balance date for any credits which are able to be taken back into the previous financial year.

Records required

- Cash books/bank statements;
- Cheque butts, deposit butts;
- Documents relating to the purchase of fixed assets;
- Hire purchase/lease agreements;
- Solicitors' settlement statements;
- GST returns and workpapers;
- Wages reconciliation;
- Term loan statements;
- FBT return copies;
- Log books;
- Stock sheets;
- Debtors list; and
- Creditors list.