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# TOP

# TAX

# TIPS

*for  
2010*



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## BOOK EXCERPT

# Good structures can mean less tax

**N**ew Zealand Investor is pleased to present this edited excerpt from a new book: *Smart Money – How to structure your New Zealand business or investments and pay less tax*. This is written by Sheryl Sutherland, an experienced financial planner, and Martz Witty, a qualified chartered accountant.

## Chapter two: When less is more – paying less tax

This chapter provides an overview of the three ways to pay less tax, with a look at deferring the inevitable and an A-Z of possible deductible expenses.

In most cases you don't pay tax until you have made money. (Yes, we said in most cases – there are exceptions.) It follows, then, that every dollar you don't have to pay in tax is a dollar you have already earned and therefore a very easy dollar for you to keep.

There are only three ways to pay less tax:

1. evasion
2. deferral
3. earning less.

### Evasion

In Chapter 1 we went into some detail about the penalties surrounding tax evasion. In no way do we, nor will we, support or recommend tax evasion.

### Deferral

As the name suggests, this is merely putting off the inevitable. However, there is a significant advantage in having use of as much cash as you can for as long as possible. If this means that you can pay your legitimate tax dues later by utilising the various idiosyncrasies of the taxation legislation, then it would follow that that might be a good thing.

The general timing provisions for the allocation of income or allowable expenditure are laid out in the Income Tax Act 2007. In the



Sheryl Sutherland and Martz Witty

absence of any specific timing regime, assessable income is recognised in the income year when derived, and allowable expenditure is deductible when incurred. Examples of specific timing regimes are those relating to certain income from leases and income derived on compulsory acquisition of land.

### Deferral through leases

While there is no general averaging provision in the Act, certain sections allow allocation of income between the year in which it was derived and later years. Goodwill, fines and premiums are income when received by an owner of land from any lease affecting the land or by any person on the disposition of any real or personal property, but only if it is the business of that person to deal in such property or if the person acquired it with the intention of disposing of it.

Here's the anomaly: although the amount received is income derived in the year of receipt, the person may apply to have the income allocated between that year and the five later income years. The notice of request must be given in the tax year following the tax year in which the goodwill, fines and premiums are derived. The Commissioner may cancel the income spread. In such cases, the balance of the income unreturned is allocated to the income year before the year of cancellation.

### For example: Assessable income

A client once sold an inherited family block of land with plenty of trees on it. No advice was sought and as part of the subsequent sale of the inherited block it was agreed that the timber standing on the land be milled. The client saw this purely as an increase in the value of the effective sale price of the land and failed to declare any income, thinking the sale of the land wasn't taxable so neither would the sale of the timber be. He was wrong, very wrong. The sale of the trees was actually assessable income and he failed to declare it, or pay tax on it. The result was a veritable mess of unpaid taxes and penalties.

### Timber

Income derived from the disposal of timber, the right to take timber, or land with standing timber on it may be spread over the year of disposal and any one or more of the previous three income years. To take advantage of this concession, the person who has disposed of the timber must make a written application to the Commissioner within 12 months of the end of the income year in which the disposal



takes place. If the Commissioner agrees, and the income is allocated to two or more income years, the same proportionate amount of any income deduction allowed for the cost of timber must be spread back as well. The disposal of timber in question includes a disposal of sawn or standing timber and the grant of a right to cut and remove timber.

Interestingly, the entire Forest Industry has a number of 'quirks' at its disposal. If you are involved in timber then it's a definite 'must-chat' with your adviser.

### Sale of land to the Crown

A person may spread any income derived from the sale of land to the Crown, whether that land is compulsorily acquired (under the Public Works Act 1981) or otherwise. A written application to spread the income must be made to the Commissioner within 12 months of the end of the tax year. Later applications may be accepted but purely on a discretionary basis. The Commissioner may also require satisfactory arrangements to be made for payment of tax on that income. The Commissioner may permit the income to be spread between the year in which it is derived and any three later income years. In addition, the same proportionate amount of any deduction allowed for the cost of the land must also be spread back.

### Stock valuations

Certain specific industries have concessions available for timing and stock valuations. This can have the effect of pushing income from one year into another, thus saving tax in the current period.

Different balance dates can prove useful to defer income to a later tax year. Deferral is merely putting off the inevitable, and advantages are usually one-off. Most businesses and individuals in New Zealand have a 31 March balance date. Taxpayers can apply to file tax returns on the basis of a corresponding income year that ends with their year-end. Any such application must be in writing and must fully state the reasons for the application. Generally, only a person carrying on a business will be given approval for a non-standard balance date. Typically, any approved non-standard balance dates continue to apply until the taxpayer requests that it be altered. The corresponding income year for a tax year is one that ends in the period starting on 1 October in the tax year and ending on 30 September immediately after the tax year.

Example A:

Accounting year	Corresponding income year
31 January 2009	31 March 2009
31 October 2009	31 March 2010

As a general rule, an application for a change of balance date will not be approved if the change is for reasons of tax deferral or tax avoidance or to take advantage of any tax concession. For example, the Commissioner's policy is not to allow a person to carry back a known income or loss

into a prior tax year. This would occur when the person applies for a new balance date after the anniversary of the old one and requests the new balance date to apply from the previous tax year. Further, the Commissioner will not agree to a change to a balance date that is earlier than the date of application.

### Pay less tax because you earn less

At first glance it seems like an oxymoron. Why would you earn less just to pay less tax? However the overarching principle of earning less and therefore paying less tax is warranted with a bit of lateral intention. There are four broad ways to earn less and therefore pay less tax:

1. sell less
2. have income treated as capital instead of revenue
3. income split and enjoy different tax rates
4. claim more expenses.

### Pay less tax by selling less

All other things being equal, selling less is not the cleverest way of paying less tax because you will be left with less money for yourself as well.

### Paying less tax by treating income as capital instead of revenue

This is a wonderfully 'grey' area for some people. Generally speaking if you buy something (anything) with the intention of selling it, then any profit earned from that sale will be assessable and has to be declared in your tax return. Conversely, any loss may be deductible. But what about an item that you buy and sell for a significant increase in value where a sale was not intended (e.g. a family home or a rental property)?

New Zealand currently enjoys the benefits of not having a comprehensive capital gains tax (so long as you are not in the trading of that item or commodity). The issue has been considered a number of times since December 1989. The government's latest stance is that a general capital gains tax would increase the complexity and cost of the tax system.

Interestingly, it was recently claimed that about 74% of property transactions are already taxed as normal business transactions. Ultimately it comes down to intention and it would be very prudent to keep file notes of intentions. Equally interesting was a recent clampdown on property tax dodgers which netted IRD an extra \$25m. Some IRD audit gangs are dedicated to tracking and tracing property transactions and significant revenue is added to the IRD coffers from this.

If you want to play in this arena then get advice first. There have been numerous court cases in which taxpayers were trying to claim something was capital when it was, frankly, just another transaction in their business.

For further information visit [www.moneysmarts.co.nz](http://www.moneysmarts.co.nz)