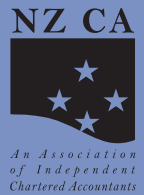




# Trial Balance

THE OFFICIAL NEWSLETTER OF NZ CA LIMITED  
June 2006 ISSUE FIFTEEN



## Buying a Business

Most people pay for the following:

- Plant
- Equipment
- Furniture and Fittings
- Goodwill
- Stock at valuation

Usually the seller retains the accounts receivable, accounts payable, bank accounts and often, particularly in the case of very small businesses, the vehicle(s).

Generally, but not always, what is an advantage to the seller is a disadvantage to the buyer. You want the selling price to be split so goodwill is valued low and everything else high.

### Conclusion

As a buyer you will want to split the price so you have the lowest possible figure for goodwill and the highest possible for plant. It is best to agree values on each asset bought. The seller usually gains from a high value for goodwill and a low value for assets.

Generally IRD does not interfere with prices set between buyers and sellers so long as the transaction is at "arms length". "Arms length" means the buyer and seller are strangers.

No law exists to determine what happens when buyer and seller do not specify the split of assets in the sale and purchase agreement. It follows each must make their own decision and be ready to justify their choice to IRD if called upon to do so.

## Capital Gains Tax

WE ALL KNOW that New Zealand does not have a Capital Gains Tax as such. However there are new government proposals which if enacted will change the way that certain offshore investments are taxed.

If you are an individual and invest directly in Australia, USA, UK, Canada, Japan, Germany, Norway and Spain you are generally taxed on dividend income only under the current rules.

Under the new rules, all offshore share and unit trust investments (with the exception of Australia) will be taxed on 85% of any capital gain plus dividends.

The new rules will not apply to "small" individual investor's - where the total cost of the share portfolio (again excluding Australia) is less than \$50,000. Please note that the \$50,000 concession does not apply to Family Trusts and these will need to apply the new rules on all offshore investments that will be covered in the new regime.

There is however a cap of 5% in any one

year where tax is limited to 5% of the gain and any excess is carried forward to future years.

Conversely losses will be treated similarly as a deductible item subject again to claiming 5% of the loss in any one year and carrying the balance forward to future years.

If you invest indirectly through managed funds it seems that these funds are likely to benefit from the new rules. Funds that elect, from 1 April next year, to take advantage of the proposed new "flow-through" rules will no longer pay tax on Capital gains on NZ and Australian shares.

In summary, managed funds investing is likely to benefit from the changes whereas investments offshore (other than Australia) are likely to be adversely affected by the proposed changes.

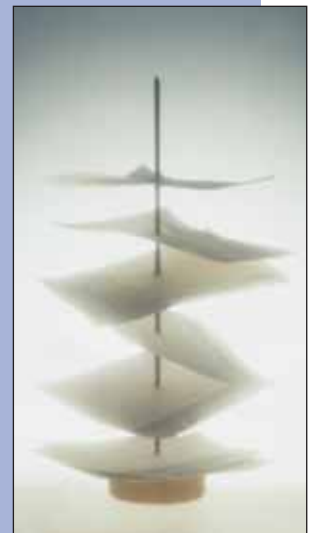
All investors should review their portfolios with their Fund Manager or Accountant when completing this years annual review or Income Tax Return to obtain specific advice.

## Tax Invoices – Make sure you have them all

IF THERE IS A GST inspection, the first thing the inspector will look for is tax invoices. Can you answer yes to these questions?

- Do you have a current tax invoice for your rent?
- Do you always get a tax invoice when you buy postage stamps, costing more than \$50 at one time?
- Do you ever check for missing tax invoices?
- For amounts in excess of \$1000, do you make sure all the details are on the tax invoice? Do you know what these are?
- Do you make sure you have a proper tax invoice when you buy a car - if buying from non registered person, keep a record similar to that needed for a tax invoice, but excluding GST number, of course.

Tax invoices for more than \$1000 must show name and address of the buyer, name and GST registration number of the seller, the words "Tax Invoice" in a prominent place, quantity and description of goods or services supplied, amount charged plus GST or statement GST is included.



# Fringe Benefit Tax

## Changes and Existing 9 to 5/Flip Leases

AS OF 1 April 2006 there were numerous changes to the FBT rules, among the main changes were the following:

**9 to 5/Flip Leases** – These types of leases will no longer provide an effective mechanism against the imposition of FBT as the Government has moved to neutralise their effectiveness.

**Calculating FBT** – Owners will have the choice of calculating the fringe benefit based on the vehicle's depreciated tax value (with a minimum value) or, as at present, its cost price.

The rate applying to the cost price has been reduced from 24% to 20% of the cost of the vehicle. (The equivalent rate under the tax book value option is 36%).

**9 to 5/Flip Leases** – The 9 to 5 leases have been popular with shareholder-employees. A person leases their vehicle to their employer and the terms of the lease agreement provide that the lease is effectively suspended should any private use occur. The Government regards 9 to 5 leases as contrary to policy intent and has now introduced new rules to override the ability to suspend the lease so private use is treated as a fringe benefit.

**Existing 9 to 5/Flip Leases** – There are two recommendations with respect to vehicles which were previously subject to 9 to 5/Flip leases.

- 1). Cancel the existing lease and take the vehicle outside the business/FBT net, treating it as a private vehicle.** This assumes an analysis of the Pro's and Con's of retaining the vehicle inside the business and paying FBT has been undertaken and the decision is made that no benefit exists in suffering FBT.
- 2). Vary the existing 9 to 5/Flip lease to ensure that it provides for payment of 100% of the running costs and lease fee i.e. accept the FBT liability.**

**NB.** The vehicle should not be transferred to the employer (if associated persons) due to the increased FBT cost in at least the first year and other specific issues including GST, depreciation and motor vehicle lease company requirements.

**NB.** The Government is currently drafting further retrospective legislation that may make option 2 even less attractive.

**Alternatives to 9 to 5 Flip Leasing** – There are several alternatives to choose from, however generally the most tax effective in the circumstances is Cost Reimbursement. The end result of this approach is that, in relation to leased vehicles, the business use percentage of all costs becomes tax deductible to the employer, however, the reimbursement is tax free to the employee.

**NB.** If the vehicle is owned by the employee you are unable to be reimbursed for depreciation as it is not a reimbursable cost – the logic here is that depreciation is not expenditure incurred but represents a loss in the value of an asset.

**Cancellation of Existing Leases** – If leases are to be cancelled there should be a cancellation fee charged, as failure to charge a lease cancellation fee may give the IRD the opportunity to argue that the lease is not on arms length terms and attempt to strike down the lease and reverse any benefits of 9-5 leases in prior periods.

**What should you do?** – If you fall into one of the following categories:

- You currently have a Flip lease in place with your company/trading trust/employer;
- You or your company currently owns a vehicle that is subject to FBT; or
- You are likely in the future to own or lease a vehicle that will become subject to FBT.

We recommend that you contact your Accountant or Tax advisor immediately to discuss the impact of the proposed changes and how best to structure your affairs from 1 April 2006.

## Lotto Tickets

IF YOU HAVE a family trust, use it to buy your Lotto tickets. If you win, wouldn't you want it to belong to the trust? Imagine trying to gift \$1 million to your trust at the maximum rate of \$27,000 a year! You must be able to prove the trust bought the winning ticket. Do this by getting the trustees to pass a resolution to buy the tickets. It is best to draw a cheque on the trust as well and pay it to yourself in advance for, say, a year. Don't forget to keep the process going.

## Telephone

IF YOU USE your telephone for both business and private use, IRD accepts a split of rental of 50 percent to the business and 50 percent private. You are expected to allocate toll calls on an actual basis.

A recent discussion paper put cell phones in the too hard basket. It seems as though the policy will be to allow a 100 percent deduction for cell phone charges so long as the cell phone is used primarily for business.

## Log Book – when did you last keep one?

IF YOU ARE A sole trader or are in partnership and use a vehicle for both business and private running, you must keep a log book unless all the running is for business only. If there is only the one vehicle available for the business and family, the IRD will assume it is being used on occasions for private use.

The following has been copied from an Inland Revenue publication. These are the minimum logbook requirements:

Section DH 3(2) requires that a logbook meets these conditions:

- It is kept for a period of not less than 90 consecutive days.
- It records complete and accurate details of the reasons for and the distance of journeys undertaken for business purposes, and such other details as required by the Commissioner.
- It records the total distance travelled by the motor vehicle during the period the logbook is maintained.

# Can you sell your business when you retire?

THIS QUESTION DOES (and should) occupy the minds of business owners nationwide.

Whether you're approaching the time when you choose to sell or not, your business should be as sale ready as possible. After all, a readily saleable business is operating at top level and you just don't know what may change in your personal circumstances at any time.

To be readily saleable your business shouldn't rely upon you or any specialist skill or knowledge you have.

So, how do you get your business independent of you:

- Train employees in every aspect of your business.
- Then keep them by providing excellent working conditions and prospects for promotion and ownership.
- Document all the aspects of your business in a practical "how to do" format so new owners and employees have easily accessible notes on what to do.
- Ensure you have a well thought out advertising plan including prepared

plans for "boost the activity" promotions for quiet times. An advertising plan isn't difficult to prepare. Just start by grabbing an annual wall planner and put in the activities then put the individual promotions and activities together in detail. The wall planner allows you to identify gaps in your programme.

- Continually challenge whether you need to be doing the things you do in the business. Delegate the things you can and make sure you can hand over the things you do to a new owner operator or manager.

Documenting the processes in a business has long been promoted as increasing the business value but is often dismissed as being too hard to achieve and keep up to date. This is now not so, with excellent software on the market to effectively document and update the information. Your accountant can provide you with contacts for good software providers and help you get started. There are examples of businesses doubling good levels of profit by committing to

documenting their systems. And of course this improved the saleability of the business and its value.

We recommend you don't place reliance on one particular buyer for your business. That loyal employee may just not have the money or may have a change of plans. Think in terms of sale to unrelated people looking for owner operator opportunities, or professional investors, your competitors or large corporates. By considering each of these options you'll open your mind to what you need to do to ready your business for sale.

Your accountant has access to New Zealand trading statistics as well as recent New Zealand business sales statistics and their relationship to financial results. Through this they can help you to:

- Compare your business to your competitors.
- Establish a likely sale price.
- Help you put a plan in place to maximise your financial results, the value and saleability of your business.

## Travel Expenses

WE ARE OFTEN asked :“What can I claim?” Here are some guidelines, which hopefully will help you. There are three situations:

### Business is the prime purpose of the trip

The airfares are fully deductible. Apportion accommodation and food on the basis of the number of days engaged in business and the number of days engaged in holiday. You could have a situation where the prime purpose is business, but the holiday element is more than 50 percent. Obviously, the greater the time you spend on holiday and the less on business the more the trip takes on a prime purpose of holiday.

### The trip is partly business and partly holiday

In this case all the costs should be apportioned on a time basis. Your objective should be to show your claims are fair and reasonable.

### Prime Purpose is holiday

In this case none of the air travel is claimable. Apportion accommodation and food based on the number of days on business compared with the number of days on holiday.

### General Rule

You have to be prepared to prove your case. While you are away, keep a diary

with details of who you visited and approximately what happened.

The onus is on the taxpayer to prove the claim for travel costs is correct. This requires evidence. Was this really a business trip or is there an attempt to camouflage a holiday as though it were business? Telephone calls, e-mail messages, faxes and letters before the trip are strong evidence to support its business nature. Similarly, one would expect appointments made to meet people, unless, of course, this happens to be a trip to a trade fair or conference. A diary of events is invaluable. What were you doing each day? Split your time fairly between business and pleasure and there should not be too much difficulty with the IRD.

### Expenses

You will have all sorts of expenses during the day and it will be hard to keep track of them. You should discipline yourself to record your expenses every evening. If you leave them, you will forget them.

As a cross check, try putting, say, \$50 in one pocket and paying out your expenses only from there. At the end of



the day, count the money you have left. The difference is the amount you need to account for. Don't be surprised if it's hard to remember where the money went.

### Taking a spouse or partner with you

This is a tricky area. There are some conferences where it is expected you will take an accompanying person. In this case the partner's expenses could be fully deductible. You should check with us in advance if you want a definitive answer.

Generally, taking a partner with you will not be tax deductible. Treat all the additional costs relating to that person as not tax deductible. Examples include airfares and food. Hotel accommodation will be incurred for business purposes whether or not there is an accompanying partner. If the cost would be the same with or without the extra person, it is unnecessary to make an apportionment.

# Borrowing for your company

SMALL COMPANIES ARE often financed with substantial loans from shareholders. This does not have to be the case. Shareholders can arrange for the company to borrow and repay money owing to them. They will probably have to offer their home as security but this does not make the loan a personal one.

The use to which the money is put determines the tax deductibility. If the company borrows money to refinance its debt to shareholders, the money is being used for the business. The interest is tax deductible.

Many clients overlook this opportunity. They will use hire purchase to buy themselves a new car when they could have got their company to borrow the money and enjoyed a tax deduction of the interest. When a shareholder rearranges finance so the company borrows the money, we recommend there is a letter from the shareholder to the company demanding

repayment of the current account.

As usual, it pays to check with us before proceeding.

## Gifting

MANY PEOPLE WHO have family trusts overlook their annual gifting. Each person is allowed to give away up to \$27,000 in any 12-month period. There needs to be a Deed of Forgiveness of Debt and a special form filled out for the IRD. If you forget to attend to your annual gifting you cannot go back. The time is lost. Gift statements have to be lodged with the IRD within three months of making the gift.

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## Are you doing anything about it?

Every three months we send you a newsletter. We try to pack it full of ideas to increase your wealth. How many of these ideas, which have appealed to you, have you implemented? If your answer is zero, why not go back over the last few issues and pick out something you like. As they say, "just do it".

## Interest Paid to Family Members

IF YOUR BUSINESS pays more than \$5000 you must deduct tax from the interest payments and pay it to IRD.

## Changes in Particulars

Please remember to let us know of any changes in:  
\* Physical address \* E-mail address \* Phone and/or fax numbers \* Shareholdings \* Directorships \* Trustees  
Or anything else that may be relevant.

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