

# NEWSLETTER

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## Income Splitting for Families

In April 2008 the Government released a discussion document that looked at the merits and possible methods of "income splitting" as a means of providing additional support to families with children.

Submissions received in response to the discussion document have been considered by Government, and in December 2009 an issues paper was released. The release of the Issues Paper reflects the next step in the public consultation process which typically precedes the introduction of draft legislation. The issues paper considers the following in more detail: how the scheme would work, eligibility, its administration, and seeks further public feedback.

New Zealand's personal marginal tax rates place a lower tax burden on low income earners. Income splitting seeks to take advantage of those lower marginal tax rates by shifting income derived by one parent, which is taxed at a higher rate, to the other parent and taxing it at a lower rate. The difference between the tax payable before and after the income is divided is refunded to the primary caregiver.



For example, Mr Brown earns \$60,000 and tax of \$12,850 is deducted. Mrs Brown earns \$10,000 and tax of \$1,250 is deducted. Their total family income is therefore \$70,000, and \$14,100 of tax has been deducted. Under the scheme their income is split 50:50, i.e. \$35,000 each, and their total tax liability would be \$12,320. The difference of \$1,780 (\$14,100-\$12,320) is refunded.

As the tax credit is based on the year-end total income of the family, the credit will be calculated the same regardless of whether the family's

income is generated by salary/ wages or self-employment.

If parents are separated and there is a shared-care arrangement for a child, both parents (if in new relationships) may be entitled to receive a tax refund. An entitlement would arise if the child was in each parent's care for at least one-third of the tax year based on the proportion of time each parent cares for the child. In the example above, if Mr and Mrs Brown were separated, were in new relationships, and shared the care of the child equally, they would receive \$890 each at the end of the year (50% of \$1,780).

It is expected that the scheme would cost approximately \$450 million a year.

The submissions received from the 2008 discussion document show that while individual taxpayers support the idea, most submissions from professional institutions are against the proposal. Their concerns included inequity arising from different family structures, potential disruption of family life with the primary earner being incentivised to work longer hours, potential for abuse, and the fact that the fiscal cost will need to be transferred to other taxpayers.

## Year End Processing

For most taxpayers the end of March represents the end of the financial year, so now is a good time to check that the books are in order. In some cases 31 March is the crucial date for getting things done. Some of these have been outlined below.



**Bad Debts** - in order to claim a deduction for bad debts they must be written off before the end of the financial year in order to get a deduction in that year. When assessing whether or not a debt can be written off, businesses will need to consider things like the age of the debt and the likelihood of the debt being collected. In the current economic climate, more emphasis should be given to debt collection. However, if debts do not look collectable, they should be written off to provide a more accurate reflection of the business's profitability.

**Assets** - equipment purchases should be reviewed to ensure that any assets costing more than \$500 are capitalised for tax purposes. This can often be overlooked especially where such assets are expensed for accounting purposes.

**Subvention Payments** - for group companies that recorded subvention payments in their 2009 income tax returns, time should be spent to confirm those payments are made by 31 March 2010, because in order for a subvention payment to be effective for tax purposes, the physical payment must be made by 31 March of the following year. In some cases the tax return is completed to include the effect of the subvention payment, however the actual payment is not made by the deadline. The effect of this non-payment is that the subvention is deemed not to have occurred.

**Holiday Pay** - entities wanting to get a deduction for accrued holiday pay or employee bonus

payments must ensure that the holiday pay and bonus payments are "incurred" at balance date and paid within 63 days of balance date.

**Herd Scheme Election** - for farmers wanting to exit the Herd Scheme, the election must be done at least a year and a day before the income year in which the National Standard Cost scheme is adopted.

**Income Equalisation Scheme** - this is a useful tool for farmers wishing to adjust their taxable income. Where farm income for the year is high, and insufficient provisional tax has been paid, the farmer should consider making an Income Equalisation deposit to reduce the possibility of use of money interest being charged. Conversely, if there are tax losses for the year, an Income Equalisation refund may be sought to offset against the losses.

**Imputation Credits and Dividends** - if a company has imputation credits that have arisen based on the old company tax rate of 33 percent the question should be asked whether or not to declare a dividend to shareholders to utilise those credits. The cut off date for declaring dividends to utilise those imputation credits is 31 March 2010 irrespective of a company's balance date. From 1 April 2010 imputation credits are limited to the equivalent of 30 percent - in line with the current corporate tax rate. Before a dividend is declared, consideration should be given as to whether or not it will get taxed in the shareholders hands at the top personal marginal tax rate of 38 percent versus imputation rate of 33 percent and whether cash is available to meet that tax shortfall.

There are quite a number of issues that need consideration before the financial year end - the above are offered as reminders of some of them.