

"WHERE SUCCESS  
BUILDS SUCCESS"

Newsletter for Cleland Hancox Limited

Winter 2010

KO TO KOUTOU HOA | ROTO I NGA MAHI • YOUR FRIENDS IN BUSINESS

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## Government Considers Repeal of Gift Duty

The Government intends to repeal gift duty if concerns around creditor protection and social assistance targeting can be addressed, Revenue Minister Peter Dunne has announced. The alignment of the top personal tax rate with the trustee tax rate announced in Budget 2010 may significantly reduce the motivation to minimise tax obligations through gifting to trusts. "Officials have been reviewing the gift duty rules for several months, and a strong case has

emerged for repealing the rules altogether. However, there are still some valid concerns around preventing gifting which may undermine the interests of creditors or which enables access to social assistance."

"There will be further consultations over the next few months, and if gift duty is to be repealed, I intend to include it in a tax bill to be introduced in November this year." Mr Dunne said.

## Governments Are Laying The Groundwork For The Next Crisis

With Thanks to Rodney Dickens, Strategic Risk Analysis Limited - [www.sra.co.nz](http://www.sra.co.nz)  
For the full article visit: <http://www.sra.co.nz/pdf/NextCrisisMay10.pdf>

To rescue us from an international financial and economic meltdown of Depressionary-scale governments in the major countries most impacted by the crisis - the US, the UK and the Eurozone - have borrowed truckloads of trillions to pave over the crisis. The USD 1 trillion Greek rescue package announced in May is the most recent truckload of government debt to be used to fill a gigantic pothole in the road to global economic recovery.

This report looks at what caused the financial crisis. It reveals that the global economy and especially the US economy are lurching from crisis to crisis, with the solution to one crisis laying the groundwork for the next crisis.

The current solution is "quantitative easings" (i.e. central banks printing money) and truckloads of government debt. More like super tankers of government debt! The normal consequence of which is inflation. The best

way for a government to solve the constraint imposed by a mountain of debt and crippling interest payments is to adopt pro-inflation economic policies. The more prices in general increase the more the real value or purchasing power of the debt falls and the sooner politicians can get back to doing what they do best (i.e. using taxpayers' hard-earned dollars to buy votes in election years).

The inflation threat is not imminent, but it needs to be taken seriously by businesses and investors making decisions that are impacted by inflation outcomes over the next 5-10 years. When even the Australian central bank Governor, Glenn Stevens, arguably one of the best central bankers we have seen, has warned that politicians will try and screw the scrum, this issue needs to be taken seriously even though the end game is some years away ...

## The New GST Calculations

Come 1 October 2010, the new 15% rate of GST will apply. We'll have more on how the transition will work in the next Spreadsheet.

The New Calculations - 15%	The Current Calculations - 12.5%
15% = 23 ÷ 3 x gross total = gross total ÷ 7.6666..7	12.5% = gross total ÷ 9
gross total = net amount x 1.15	gross total = net amount x 1.125
net amount = gross total x 20 ÷ 23	net amount = gross total x 8 ÷ 9

## Tough Times Require Tough Business Decisions & Actions - Are You Ready to Take Them?

With Thanks to Nigel Foster, Armillary Management Limited - nigel@armillary.co.nz

“Regardless of whether 6-12 months ago the business was weak or strong the starting point for addressing the problem is recognising that there is a problem and that it probably won't go away of its own accord.”

For quite a long period up until a couple of years ago most businesses were doing pretty well and the ease with which money could be borrowed went a long way to masking the woes of those that were not. Yes, there were examples of business distress and failures, which were largely attributed to internal problems-management, gross undercapitalisation, and product/service, reached the end of its lifecycle and no new-age substitute.

Much harsher economic circumstances over the last couple of years have really exposed businesses that were already "weak", but also put pressure on many good businesses which do not necessarily have an internal problem.

In some instances good businesses can withstand harder times for a period without having to actually address the problem- a strong balance sheet, ability to borrow further, ability to withstand a period of lower profits or even losses.

But eventually, even strong businesses have to contemplate tough decisions and actions if the tough times lead to poor trading results and a progressive weakening of financial position.

In a series of six articles we'll explore the steps involved in taking tough decisions for underperforming businesses. These steps are equally applicable to fundamentally weak businesses and businesses which had been performing strongly until the tough times came along.

Regardless of whether 6-12 months ago the business was weak or strong the starting point for addressing the problem is recognising that there is a problem and that it probably won't go away of its own accord.

We Kiwis are born optimists and there's nothing wrong with that. Tomorrow is always going to be a better day. The sales will be a little stronger, margins will improve and "look, things are going to be just fine a couple of months out, the spreadsheet forecast shows that". And even if our optimism is tested a little we hesitate to show it. Our culture has traditionally not been kind to business failure-the tall poppy syndrome, the quick leap in thinking which attributes business failure to the "inadequacy" or even "dishonesty" of the individuals involved. And what about, "it must come right. I'm working harder than ever. My wife and I simply can't do any more than we are doing"?

If you think you have a problem in your business recognise that possibility right now and start to deal with it.

Recognise that working harder in your business will probably not solve the problem. Devoting time to working on you business might. Acting sooner will leave you with a wider range of options for solving the problem in a dignified way with you still in control of the situation. Delaying acting will leave you with a narrower range of options for solving the problem in a less dignified way and with others (your creditors?) in control. Which do you prefer?

There is no shame in having an underperforming business. There can be shame in not recognising that you have an underperforming business and dealing with it.

In the next articles we will discuss the five steps in the business turnaround process once the proprietors have recognised that "now is the time to deal with the issue".

## Should You Keep Your Family Trust?

With the budget announcing a move back to the top personal tax rate being the same as for trustee income, some are asking, should they keep their family trust?

In our view, undoubtedly "Yes!". Most people set their trust up for asset protection and estate planning. Those needs likely haven't changed. Trusts also provide some flexibility in how various people manage their financial affairs.

And for those people thinking that with the

company tax rate moving even lower to 28 cents, that they will leave more profit in their closely held company, you need to think how you will extract that profit to spend and / or invest outside your company. So your trust's substantial ownership of your company is likely for most still the right structure.

Make an appointment to discuss this with us please, if you have any doubts.

## Out With The Old, In With The New - LAQC's / QC's

Of all the Budget tax announcements, it would seem the one that has motivated the most feedback is LAQC's. We were warned that IRD had loss attributing qualifying companies in its sights!

In the Budget, Finance Minister Bill English announced that LAQC's will be treated like limited partnerships from 1 April 2011, meaning QC income will go into the shareholders' tax returns and a loss limitation rule will apply to losses.

The detail of the announcement was released after 5:00p.m. on Budget night and the devil sure is in it.

From 1 April 2011:

1. LAQC's and QC's as we know them will go.  
2. Existing LAQC's and QC's will become a flow-through entity called a QC.

3. All income of the QC will be taxable to the shareholders in proportion to their interest in the QC.

4. Losses of the QC will be deductible to the shareholders in proportion to their interest in the QC; but,

5. The loss deduction will be limited to the shareholders' economic interest in the QC ("the loss limitation rule").

6. QC's will be defined and treated as a partnership for tax purposes rather than a company, meaning:

- Profits, capital gains, interest received, dividends received, expenses etc. will have to be distributed proportionately to all shareholders.
- Private use adjustments will apply.
- Working shareholders will have to have an employment contract and be in the PAYE system for "shareholders-employee salaries" to be deductible.
- Shareholders will be personally liable for tax on remitted debts.
- If a company ceases to be a QC there will be deemed disposals of assets at market value with the shareholders facing depreciation recovery, tax on gains from trading stock and possibly land.
- The ceased QC will be deemed to acquire the assets at market value.
- If a QC is liquidated there will be a disposal with tax consequences to the shareholders and if the assets are taken

over in specie there will be a deemed acquisition at market value.

- No imputation credit accounts will be required as all dividends will be tax-exempt.
- No limitation on foreign sourced income.
- All QC's will only be allowed to have one class of share.
- The QC will file an IR7 Partnership tax return.
- It appears (although the detail is unclear on this point) that trustees will be required to return QC income (taxed at 33%) rather than the current requirement to pass dividends through to beneficiary.

### Losses

The use of QC losses by shareholders will be subject to a loss limitation rule.

Shareholders will only be permitted a deduction for losses to the extent of their investment in the QC.

This is similar to the rule applying to limited partnerships. It is believed the value of personal guarantees will be able to be taken into account in calculating the extent of a shareholder's investment.

The value of guarantees are taken into account when calculating the level of investment in a limited partnership.

A shareholder in a QC will usually have made loans to the QC and guaranteed debt. The consultation document is silent on this point.

We would expect however that the value of guarantees will be taken into account.

Unutilised losses will be carried forward by the shareholder.

### So, what does this mean?

For property investors (or those that remain) the QC has probably had its day. We would be inclined to look at individual / partnership ownership of property investments or if the long term view is taken - trust ownership.

For small business, it's likely great! For others, a company is a company and that's what they want.

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## What About Buildings Eventually Sold At A Loss?

“IRD have not indicated that losses on the sale of buildings that have not been depreciated will be deductible.”

Will any loss be income tax deductible because of depreciation factors if a building is sold for less than its book value?

IRD have not indicated that losses on the sale of buildings that have not been depreciated will be deductible. The legislation introduced to give effect to the 0% budget announcement for depreciation of buildings, did not amend the Tax Act which prohibits a deduction for a

loss on the disposal of a building.

Continuing to deny a deduction for a loss on the sale of a building is in line with the stated reasons for denying a depreciation deduction - namely, that, on average, NZ buildings do not drop in value over time. Continuing to disallow a deduction for a capital loss on a building is also consistent with the treatment of losses on other capital investments.

## Amended Tax Law Definition of Beneficiary Income

The definition of beneficiary income in tax law s.HC 6 has been amended extending the six month period within which a trustee must allocate income to the end of the six month period or the period within which the trustee either files or is required to file a return.

The purpose of the amendment was to address problems where tax agents were effectively required to prioritise the preparation of trust

accounts and tax returns over other accounts and returns in order to meet the six month deadline.

It is, however, common for Trust Deeds to include a clause that provides that any income not allocated or paid within six months will be capitalised. Accordingly, care is required to ensure that the terms of the Trust Deed allow available income to be paid or applied outside the six month period.

## Focussing on Energy Efficiency is Key for SMEs

With this big picture debate and all the negotiations taking place, it is important to remember that the core of this issue at hand for small and medium businesses, is energy efficiency. Regardless of the impact of an emissions trading scheme into our economy, there are ways and means of saving energy right now. The costs associated with various business inputs including electricity are on the rise so focussing on solutions to use less energy to produce the same or a greater result can only help to improve the financial performance of small and medium businesses.

Another key issue for small and medium businesses is increasingly in relation to pressure

that big business is placing on their suppliers to manage their greenhouse gas emissions. Big businesses are preparing as if the legislation is already in place. Like many small and medium businesses they understand that taking a proactive stance on managing their own greenhouse gas emissions sends a positive message to the public. An easy way for big business to eliminate a large portion of their problem is to place pressure on their suppliers to either manage their greenhouse gas emissions or choose suppliers that are carbon neutral. Herein lies the risk for suppliers who fail to recognise this in 2010. On the flipside, it is an excellent opportunity for those who are proactive in managing their own greenhouse gas emissions.

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