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**W**e are excited to share with you the first edition of our bi-monthly newsletter BDO Know How! This new business publication will provide updates on key business and tax issues which you need to know to optimise your business.

We hope you enjoy the quick snippets of information and news that may be helpful to you.

If you have any feedback, ideas or requests for information, please feel free to email them to [editor@bdo.co.nz](mailto:editor@bdo.co.nz)

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## MY CURRENT ACCOUNT IS OVERDRAWN?

Those who operate their business via a company structure know that the company is a separate legal person and its certainly not the same person as the shareholders, directors, and employees. So even though the company may feel like it's yours, or a manifestation of you, it's not, and Inland Revenue's tax treatment of companies is very different from sole traders and partnerships.

At an operational level, one of the key differences for companies are transactions that occur between the company and the shareholders. These are accounted for in the shareholder's current account. Drawings is probably the best example of this.

In cases where the amount drawn out of a company by a shareholder exceeds the balance of the current account, the account becomes overdrawn. The Income Tax Act unfortunately deems these overdrawn amounts to give rise to 'dividends' in the first instance.

Dividends are of course taxable income. One way to bring the overdrawn current account back into funds is to allocate company profits as shareholder salaries or dividends (both of which are taxable). Failing this, the company could charge the shareholder interest on the overdrawn current account to remove it from the 'dividend' definition.

Whilst this works practically, it's ugly from a tax perspective as the company ends up paying tax on the interest received and the shareholder in most cases isn't entitled to a tax deduction.

Overdrawn shareholder current accounts are often a nemesis for SME business owners. They arise when shareholders draw more funds from the company than it earns and its particularly prevalent during lean times when a lifestyle needs to be maintained and profitability isn't there.

The trick is to monitor shareholder current accounts in the same way business profits are managed. If there isn't sufficient income to draw, shareholders will need to exercise some restraint or face the consequences of paying tax on amounts they draw from the company.



## SUMMER'S COMING, DO YOU HAVE SUNSCREEN?

With Summer coming thoughts will turn to protecting ourselves by wearing sunscreen. But, have you considered doing so with your business?

The best sunscreen a business can have is Governance – your Governance, whether that be through a formal Board, Advisory Board or just the professionals you engage, should regularly review the risks and exposures your business faces and identify what strategies can be put in place to minimise the occurrence of such adverse events. With this in mind, perhaps today is a good time to get in touch with your BDO adviser to discuss Governance and get ready for benefiting from the upside of the sunshine while wearing your sunscreen and mitigating those risks.

## CHECKING OUT THE CROWD

Equity Crowdfunding is here, and the crowd is buzzing. Check out what it is all about, from either a capital raising need or investor perspective at the two Financial Markets Authority registered providers at [pledgeme.co.nz/about/equity](http://pledgeme.co.nz/about/equity) or [snowballeffect.co.nz](http://snowballeffect.co.nz). We will also be publishing an article demystifying Crowdfunding in our next Business Edge publication due out in November.



## COMPANY DIRECTOR AND GENERAL PARTNER CHANGES – RESIDENCY AND DISCLOSURE

Changes to the Companies regulations require that every company must have at least one director that lives in New Zealand or lives in an enforcement country (Australia only at this stage) and be a director of a company that is registered (except as the equivalent of an overseas company) in that enforcement country. There is also a requirement to provide the date and place of birth of company directors.

One general partner of a limited partnership will also have to meet residency criteria and qualifications will be aligned with Companies Act requirements for directors. The powers of the Registrar of Companies are clarified to require verification of information upon request. Companies will need to disclose the details of their ultimate holding company if they have one.

Further, the Registrar of Companies will have more power to identify the true owner of a company by enquiring about:

- ▶ Individuals controlling companies and limited partnerships.
- ▶ Individuals controlling directors and general partners.
- ▶ Individuals that directors and general partners may have delegated their powers to.

These measures are designed to shore up New Zealand's company registration process against criminal activity and become law on 1<sup>st</sup> May 2015.

However, there will be a 180 day transitional period for existing companies; they will be required to meet the new requirements before 28 October 2015. If your company does not meet this requirement by the relevant date, the Registrar will have grounds to commence removal of your company from the Register. Please contact us if you would like to understand how this change affects your company and what you need to do now to ensure you comply in time.

## NEW FINANCIAL REPORTING RULES FOR 2015

Last year, the Financial Reporting Act 2013 was passed into law. The Act requires a number of changes to financial reporting, which will impact on many small and medium businesses across New Zealand. If your business is not 'publicly accountable' or 'large' (if your assets are less than \$60m or revenue is less than \$30m) then it's likely you will no longer be obliged to prepare general purpose financial reports, and instead can prepare special purpose reports for the year ended 31 March 2015 onwards.

### What will special purpose reports look like?

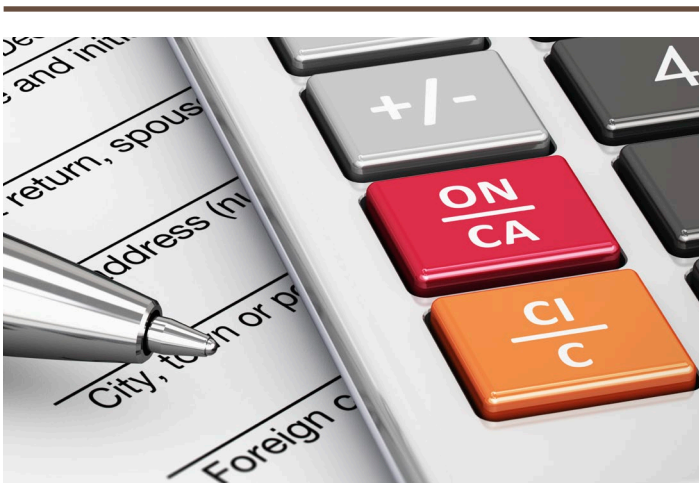
Special purpose reports will vary depending on the primary purpose they are prepared for. If the only third party to see a copy of your financial statements is Inland Revenue, there are minimum reporting standards to follow which Inland Revenue has released. These require a profit and loss statement and a balance sheet, prepared according to double entry accounting method using accrual basis, rather than cash accounting. A statement of accounting policies must be included, along with a reconciliation of income tax and disclosure of associated person transactions.

Moving up from the minimum standard specified by Inland Revenue, your bank may require financial statements to satisfy bank covenants, and these statements will need to include additional information specified by the lender.

Finally, Chartered Accountants Australia and New Zealand has released an optional special purpose reporting framework which sets out best practice in this area. The Framework has been specifically designed to satisfy the requirements of banks/credit providers, tax authorities, and owners assessing performance and making capital decisions. The key features of the Framework which make it appropriate for SMEs are: historical cost is the primary measurement basis, disclosures are less complex than NZ IFRS, reporting guidelines are principle based (can be applied across a wide range of industries), and can be readily audited. Unless otherwise specified, BDO will prepare your annual accounts using the guidelines set out in this Framework.

Will special purpose financial reports cost less to prepare? While there may be some compliance cost savings, we do not envisage these will be significant for most small businesses. Business owners need to ask themselves what their financial information needs are, and whether reports prepared to the minimum standard can provide them sufficient information for sound decision making.

► For more information about changes to financial reporting, please contact your local BDO adviser.



## TAX CRACK DOWN

Over the next five years Inland Revenue will actively ensure everyone pays their fair share of tax thanks to the Budget 2014 injection of more than \$132 million to improve tax payer compliance.

While we would expect Inland Revenue to target the higher value tax payers as well as specific industries, they will also be targeting those with unfiled returns. Clearly the best way to avoid this category is to file your overdue tax returns and keep them up to date, ahead of Inland Revenue taking a closer look.

If that brings about some tax for the past, let us deal with it on your behalf, as it is our experience that Inland Revenue is more than reasonable when an open and honest approach is taken. Which can result in a reduction in penalties or arranging of taxes to be paid overtime.

## IS TAX AVOIDANCE OKAY?

This is another one of those urban myths. Tax avoidance is not acceptable to Inland Revenue and they have very strong powers to set side and unpack tax driven deals.

In simple terms tax avoidance means structuring your affairs with an overriding outcome to alter the incidence of tax. This could also mean deferring the payment of tax to a later year, taxing income in the hands of those on lower tax rates, to name a couple. The simplest way of determining whether you have a tax avoidance arrangement is to ask yourself why you undertook the transaction in the first place. If the arrangement was largely tax driven, chances are upon review, Inland Revenue are going to take an interest in the transaction.

For those who know their business structures or practices might not stand up to scrutiny, or who are simply wanting peace of mind, we can take a look "under the bonnet" and give a tax WOF, looking at things from the point of view of a tax inspector. Effectively, it's a 'mock up' tax audit and will ensure you're informed and have choices.

Equally important is that if you or your staff have been contacted by Inland Revenue on anything other than the most routine of matters, it is prudent to let us liaise with Inland Revenue on your behalf. There are important steps we can take that can mitigate your risk before a tax audit takes on a life of its own. Remember, we have specialist tax advisers, well familiar with tax law and Inland Revenue's way of operation, so take advantage of this!





# BACH TO THE FUTURE

On the face of it, the new mixed-use asset rules (those which apply to the Kiwi bach amongst other things) appear quite complex. They're actually not.

Consider a simple yet familiar example of a holiday home rented for 12 weeks a year, used by the family for 8 weeks a year and unoccupied for 32 weeks a year. In the old days, assuming the holiday home was "available for renting" for the entire year, expenses were deducted based on a simple 44/52 basis (52 weeks available less 8 used privately). In other words, rates, insurance, and most significantly, bank interest, would be 85% deductible. Even with the removal of the depreciation deduction for the house there was often a tax loss which would be offset against your salary and result in a significant tax refund. Unfortunately those days are over.

From the 2014 tax year (1 April 2013 for most of you) Inland Revenue no longer counts the full 52 weeks in the year, so deductible expenses are now calculated based on actual usage. This includes private and rented. So in our example, the total use for the year is 20 weeks (12 + 8). Even though the holiday home might have been available for the other 32 weeks, that period is ignored for working out deductions. This means that expenses are only deductible to the extent of rental use divided by total use i.e. 12/20. Available deductions therefore go from 85% (44/52) down to 60% (12/20). And the previous removal of depreciation on building structures means you get hit twice.

There is some relief in that if you can specifically identify a cost that was incurred when the holiday home was rented out (e.g. a tenant breaks a window) or relates solely to the income earning use (e.g. advertising) then a full income tax deduction is available for that cost. However for those generic costs, like rates insurance and the big one, interest, the new apportionment rules will apply.

A worked example shows change:

The Good Old Days				Now from the 2014 year			
Rental income:	(12 weeks at \$600 per week)	7,200				7,200	
Expenses:							
Depreciation	4,500				-		
Insurance	800				800		
Interest	30,000				30,000		
Rates	3,500				3,500		
Repairs	5,000				5,000		
Total Expenses	43,800				39,300		
Less Private Weeks (8/52 x 43,800)	6,570			(8/20 x \$39,300)	15,720		
Claimable Expenses		37,230				23,580	
Loss		-30,030				-16,380	
Tax Saving at 33%		\$ 9,909				\$ 5,405	

But it's actually worse than this! In the old days the rental loss of \$30,030 would be entered into your tax return to reduce income from other sources (salary, interest, dividends etc.) and therefore the tax savings of \$9,909 were, essentially, immediate.

From the 2014 tax year this may no longer be the case. The loss of \$16,380 calculated above cannot be offset against other taxable income if the rental income received (\$7,200) is less than 2% of the value of the holiday home. So assuming the holiday home is valued at say \$400,000, 2% would be \$8,000. As the rental income is only \$7,200, the loss of \$16,380 has to be carried forward to a future year and it can only be offset if the holiday home makes a taxable profit, or if the 2% rule allows a deduction.

And if you're thinking of clever ways to increase the rent or days rented, Inland Revenue has that covered and can counter any contrivances.



## SPINNING LOSSES INTO GOLD

Coming out of the 2014 Budget is some welcome relief in the Research and Development area. Long renowned as innovators, New Zealand businesses put time and money into 'R&D', regardless of the tax breaks. However, internationally, we lag behind in terms of tax incentives.

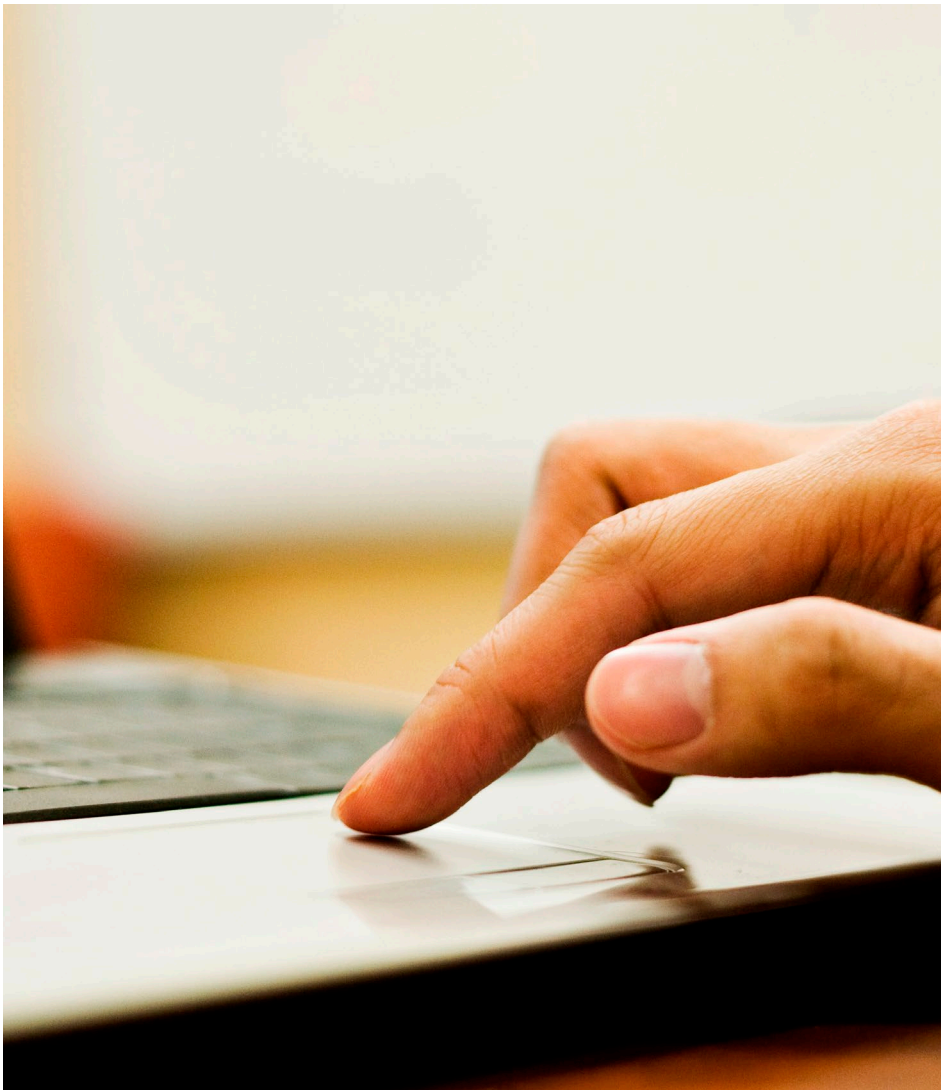
Now the Government has confirmed that loss-making R&D intensive start-ups will be able to cash-out their tax losses. This means that you don't have to wait till you turn a profit to get the benefit.

We are still awaiting the finer detail, but it's likely to apply to non-listed ordinary companies whose salary and wage bill is at least 20% related to R&D.

These benefits are likely to start at \$500,000 of eligible losses, eventually rising to \$2 million. For a successful venture this is only a timing benefit, but well welcomed all the same.

There will also be tax deductibility for certain "black-hole" expenditure. This is expenditure for which you get neither a tax deduction nor a depreciation deduction; for example, patentable inventions, designs and software development. This applies whether or not the R&D is successful. Whilst not actually available till the 2015/16 tax year, let's make sure you capture the R&D costs (from 7 November 2013) in anticipation of the changes. Make sure your accounting system's chart of accounts sorts out anything related to R&D, as that is sure to make things easier down the track.

You will need to have a higher level of detail around R&D related employee costs, training, prototype materials, and share of overheads. It will also be important to be able to isolate amounts that may not qualify, such as market research, social science related costs and cosmetic changes. So the more detail the better!



## IS IT TIME TO TRANSFER YOUR UK PENSION?

Have you got a UK public sector pension, such as an NHS, teachers, local government, armed forces, police or firefighters pension? If so, please be aware that the UK has announced significant changes to their pension rules which will see public sector defined benefit schemes as being unable to be transferred to NZ from April 2015 onwards.

If you want your pension funds transferred to New Zealand (and have certainty of your tax liabilities) you must transfer before March 2015. However due to increased transfer demand, the response rates of some pensions is up to 6 months so we recommend you must start the process in the next couple of months or it may be too late. As each person's circumstances are different and there may be tax implications, we also recommend you take appropriate advice from an approved financial adviser with experience on transferring UK pensions.

## NEW .nz DOMAINS COMING SOON

If your business has a website, now's the time to protect your brand by registering or reserving the .nz version of your domain. With a short, simple .nz domain name, you're showing the world and your customers you are a New Zealand organisation.

Second level domains' like .co.nz, .net.nz and .org.nz are now optional and you can also get a .nz domain. So if your domain was 'anyname.co.nz' you may also be able to get 'anyname.nz'.

### Your Options:

If you have an existing .nz domain name, you'll need to find out if you can register or reserve the shorter .nz version. This will depend on when you registered it. If you don't have a .nz domain name and want to get one, you now have more choice when you come to choose your domain name.

### How to get your .nz domain name

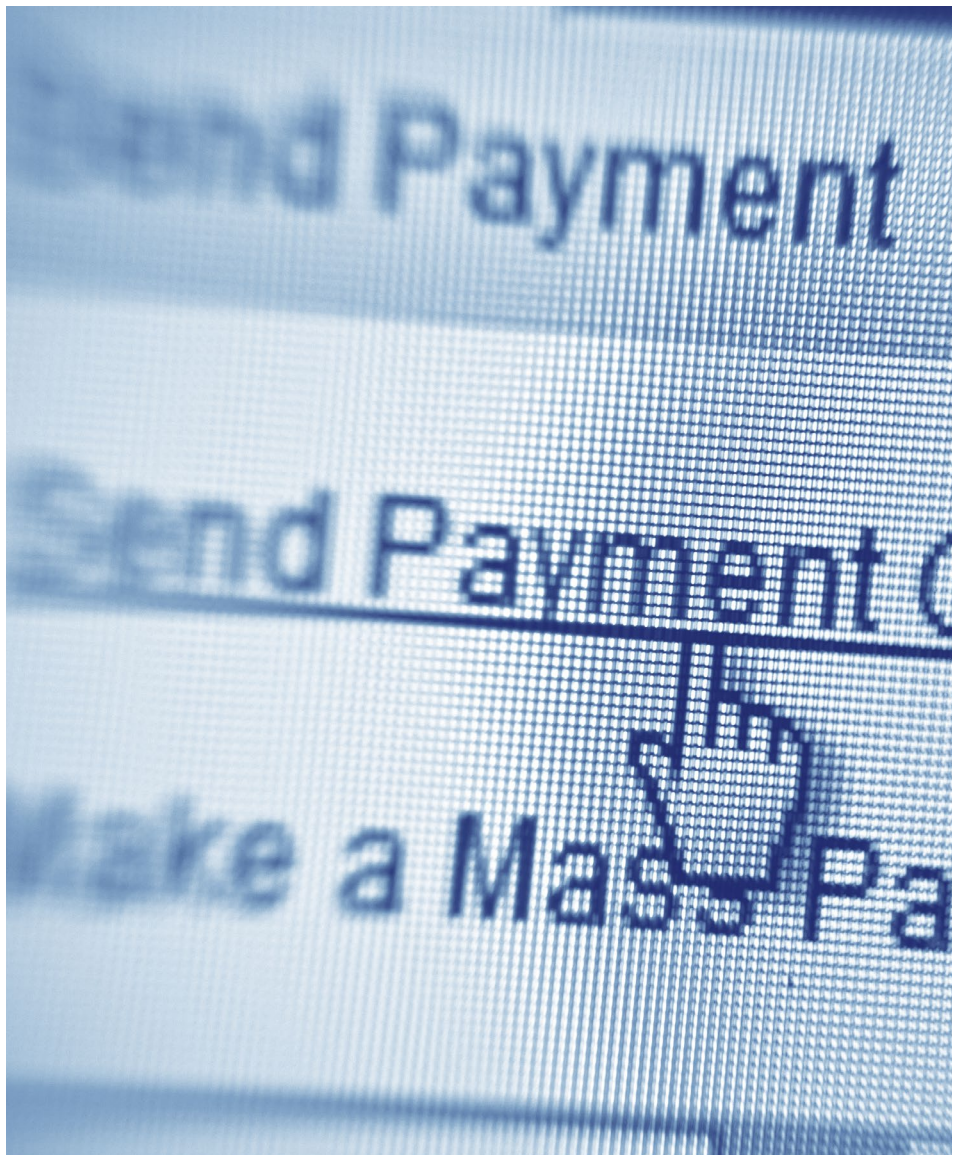
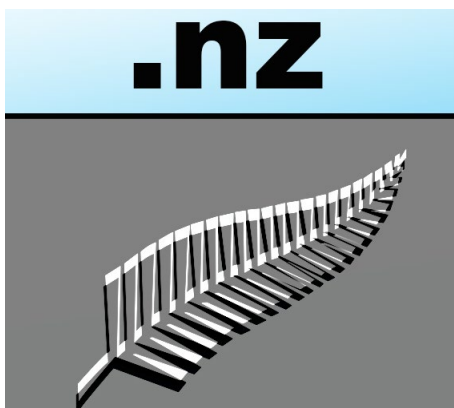
To find out if you can register or reserve your .nz name, look up your web address on the Anyname website or ask your domain name provider. You may be eligible to register the .nz version of your domain before anyone else, or reserve it for free for up to two years. If you're eligible for either of these options you can do so from now.

### 'Conflicted' Domains

If someone else has a domain that's similar to yours, you may find you both want the shorter .nz version. For example, if you had anyname.co.nz and someone else had anyname.org.nz and anyname.net.nz, you would both have the chance to have your say on who gets the .nz name.

### Existing Domains

If you're happy with what you've got and don't want a shorter .nz domain – that's fine. Your existing domain will work as normal and you'll still be able to register and use names with endings like '.co.nz' and '.org.nz'.



## ONLINE PAYMENTS TO INLAND REVENUE

From 1 October 2014, you'll need to ensure Inland Revenue receives your cheque payment on or before the due date to avoid penalties and interest.

It's important that your payment and return reaches Inland Revenue on or before the due date. If they're late, you may incur penalties and interest. This means you'll no longer be able to post cheques on the due date. You can however, make payments online up to and including the due date.

### There's never been a better time to go online

It's easy, fast and secure to file returns and make payments online, and the service is available 24/7. Last year, over 70% of all Inland Revenue payments were made electronically.

### How to pay

We recommend you pay using the "pay tax" function provided by most New Zealand banks. To make an online payment or find out more about making payments, go to [ird.govt.nz](http://ird.govt.nz) and search "make a payment".

### How we can help

Any member of your BDO team can help you with updating your payment method.

To find out more about BDO, please  
contact your nearest office on

**0800 379 528**

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