Harvie Green Wyatt
CHARTERED ACCOUNTANTS

NEWSLETTER AUTUMN 2021

Tax shakeup for business sales

Proposals in the new Tax Act will mean sellers of a business must notify buyers and Inland Revenue about the amounts they have allocated for various assets.

If they don't do this there will be rules about how this is to be handled. Also, Inland Revenue will be able to interfere with the figures, if it thinks the allocation does not reflect market value. However, it won't do so where the amount involved is less than $1 million.

When a business is bought or sold there is often an issue of how you apportion the assets.

The buyer wants to arrange the assets to get the best tax deal and the seller has the same ambition.

Think about the following situation.

A business is being sold for $2,000,000. It comprises some stock, various pieces of equipment and furniture with different depreciation rates and goodwill.

As a buyer I want the goodwill figure to be as low as possible because I can't get any depreciation or tax write-off on this figure. In my books, I give it the value of $100,000.

The seller wants to sell his stock, equipment and furniture for the smallest possible figure and places a value of $1,000,000 on goodwill.

The buyer is going to make the stock, equipment and furniture as big a proportion as possible of the $2,000,000 and the seller is going to do the opposite.

You can see the only one missing out is Inland Revenue, so it's going to tighten up the rules.

When you come to sell your business we recommend specifying in the sale and purchase agreement how the price is to be split over the various assets you are selling. When the buyer signs the contract they will be agreeing with your figures.

Loan scheme extended

The original scheme for the Government to lend $10,000 (plus $1800 for each full-time employee) to small and medium-size businesses affected by Covid -19 has been extended.

- New businesses which started after 1 April 2020 will be eligible so long as they have remained in business for six months.
- If you have repaid the earlier loan, you can draw down another one.
- You can borrow to buy new equipment and digital infrastructure, not just for running the business.
- The number of days for which there has to have been a 30 percent decline in income has been reduced from 30 days to 14 days.
- New businesses, instead of having to make a comparison with last year, can use the previous month.

Time to write off bad debts

We are in the last quarter of the year for those with a 31 March balance date. Bad debts have to be written off before balance date.

This means you must have taken all reasonable steps to get paid and conclude your chances of that are slim. You must then do whatever you can to show you have really written off the debt.

Some small businesses have simple systems. For example, they might issue an invoice but not have a debtors ledger. If you are one of these, we suggest you take a copy of the invoice and write on it something like "bad debt written off 13 January 2021".

We suggest you also put your initials or signature on this copy. You can then produce it to Inland Revenue if they ever ask for it.

There is no obligation to write off your bad debts. This might be the very year you delay doing so. If you anticipate poor income for the 2021 tax year and a higher income for the 2022 tax year, you could consider writing off bad debts in the 2022 year, if this is going to save you more tax in the long run.

Once you have written off a bad debt you are still entitled to try and get the money. If you succeed, the amount you collect becomes taxable income.

New trust annual return requirements

In December 2020 the legislation enacting the new 39% tax rate was passed. Within the same bill, somewhat overshadowed by the rate change, was the introduction of a new "annual return" requirement for trusts.

Not to be confused with the new Trustee Act that came into effect at the end of last month which requires certain disclosures to be made to beneficiaries, the annual return requirement included in the December 2020 bill imposes the disclosure of various trust information to Inland Revenue on an annual basis.

As enacted, the annual return for trusts will comprise:

- an income statement and balance sheet;
- details of any settlements made on the trust during the year;
- the name, date of birth, country of tax residence and IRD number of any person who makes a settlement on the trust in the year, whose details have not previously been provided;
- details on every distribution made by the trust during the year, including capital distributions, as well as details on the recipient beneficiaries;
- details of any person who has the power to appoint and remove trustees and beneficiaries of a trust.

The requirement will not apply to non-active, charitable or Maori authority trusts and foreign trusts that are already filing disclosures with Inland Revenue.

Although the legislation applies for the 2022 income year onward, there is a provision which allows Inland Revenue to request the same annual return information for any period between the 2015 and 2021 income years.

Inland Revenue is likely to use the information to monitor the extent to which income is being taxed to trusts at 33%, that would have been taxed at 39% if derived by individuals. That information could then be used as a basis for the Government to either increase the trust tax rate or increase the extent that beneficiary distributions are taxed to individuals.

The information could also be used by Inland Revenue to specif-

ically check other areas of compliance. For example:

Imputation streaming rules require dividends received by a trust that are then distributed to a trust's beneficiaries to be spread proportionately across those beneficiaries, otherwise imputation credits may be forfeited.

Taxable income can be triggered if a trust receives the benefit of a debt forgiveness and a subsequent distribution is made to a corporate beneficiary.

Application of the land taxing rules can depend on whether parties are associated. The level of disclosure will enable Inland Revenue to readily determine who a trust is associated to.

As time passes and the amount of information held by Inland Revenue increases, they could proactively identify errors in a trust's tax position. Especially if a trust has moved from one accountant to another and Inland Revenue has a clearer picture of past transactions than the new accountant has.

Directors' Duties

Company directors have a duty under the Companies Act 1993 to not trade recklessly or take on obligations that their business cannot perform. Balancing the continued survival of a company versus their obligation against reckless trading has been a key feature of the Covid-19 economic environment.

Recognising that the economic impact of Covid-19 placed some companies in temporary financial distress as they adjusted to their new trading environment, amendments were made to the Companies Act 1993 for the benefit of directors. The amendments provided safeguards for company directors enabling them to take a longer term view of a company's ability to trade. However, those safeguards ceased from 30 September 2020, so directors need to revert to the more stringent approach required prior to the amendment.

In a timely reminder of directors' duties, the recent Supreme Court decision Madsen-Ries v Cooper [2020] illustrates when the actions of directors will be in breach of their duties.

Mr Cooper was the sole director of Debut Homes Ltd (Debut) a residential property developer. In 2012 Debut owed Inland Revenue more than $300k of GST, amongst other creditors. Mr Cooper was advised by his accountant that these debts were insurmountable. However, with 6 properties under development, Mr Cooper persisted in expectation of the profit from their sale. Additional finance from third parties, guaranteed personally by Mr Cooper, and a loan from his family trust, were used to complete the properties and pay secured creditors. However, no GST was paid to Inland Revenue on the sale of the 6 properties, adding to the GST liability already outstanding.

Finally, in March 2014, Debut was placed in liquidation by Inland Revenue with a GST liability exceeding 500k (including interest and penalties). The High Court held that Mr Cooper breached his duties under the Act by continuing to trade in a manner that benefited some creditors but was detrimental to others.

In September 2020 the Supreme Court restored the High Court's orders and allowed the appeal by the liquidators. The actions of Mr Cooper amounted to reckless trading and a breach of a director's duty to not enter obligations on behalf of the company where there was no intention or ability for the company to meet those obligations. Mr Cooper will likely be personally liable for some or all debts of the company and potentially barred from being a director.

Perseverance has been key to survival for many businesses during COVID-19. However, continuing to trade with the belief that a business will be profitable, while ignoring the reality of the balance sheet risks directors breaching their professional duties.

The 39% rate change

The top personal marginal tax rate increases to 39% on income over $180,000, with effect from 1 April 2021. Businesses should consider what the flow-on effects are and forward plan to ensure they are not caught off guard. Two key areas are discussed in this article.

Simplistically put, a company pays income tax at 28%. Imputation credits arise from that tax paid and are used to reduce the tax payable by shareholders when dividends are paid. Further tax may be payable by the shareholder if the tax liability on the dividends is more than the imputation credits.

If shares in a company are ultimately held by an individual, consideration should be given to declaring a dividend prior to 1 April 2021, in which case it will be taxed to the individual at 33% (rather than 39% to the extent income would exceed $180,000 from 1 April 2021).This requires a comparison between the income tax liability that will be triggered upon declaring a dividend prior to 1 April 2021, versus the expected future income tax liability that will be triggered if a dividend is declared on or after 1 April 2021.

The FBT regime ensures tax is paid on non-cash benefits provided to employees, such as company vehicles and fuel cards. When calculating FBT, employers have the option of using one of the following methods:

The single rate option, where a single rate of 49.25% is applied to all benefits provided to employees.

The short-form alternate option, where rates of 49.25% and 42.86% are applied to attributed and non-attributed benefits, respectively. This appeals to employers who predominantly provide attributed benefits to employees who earn more than $70k.

The full alternate rate option, where a separate calculation is undertaken for each employee who has received attributed benefits with reference to each employee's salary. A rate of 42.86% is applied to non-attributed benefits. This appeals to employers who predominantly provide benefits to employees who earn less than $70k.

Typically, benefits that are subject to FBT are provided to higher -earners, and consequently, the 49.25% FBT rate under the default FBT method equates to the current top marginal personal tax rate of 33%, which keeps the FBT filing process simple.

The full alternate rate option takes considerably more time to calculate, and as a result, employers that value time and efficiency tend to use the single rate or short -form alternate rate option, irrespective of the cash savings that the full alternate rate can provide.

With the introduction of the 39% marginal tax rate, the 49.25% and 42.86% FBT rates will be increasing to 63.93% and 49.25% respectively from 1 April 2021. This effectively means employers that use the single-rate option will be paying FBT as if all employees earn more than $180,000, when in reality the 39% rate is expected to apply to only 2% of New Zealanders. As a result, employers may wish to consider undertaking the full alternate rate calculation from 1 April 2021, as the cash saving may exceed the additional time and effort.

In the lead up to the 2022 financial year, companies should be exploring different options to ensure tax efficiencies are achieved.

BRIEFLY

Quicker refunds

One Covid concession by IRD is to allow people who do their GST returns six monthly to switch to one monthly so they can get their GST back faster. You have, of course, to have had your business materially affected by Covid-19. If you do this, you will continue to have to put in monthly GST returns to 30 September 2021. After that you can switch back to 6 -monthly. You have until 31 March 2021 to notify Inland Revenue if you wish to change the frequency of your GST returns.

Debt hibernation

The business debt hibernation scheme is another Covid-19 concession. If your business is in financial trouble, this could help you. The scheme runs to 31 October 2021. It doesn't apply to sole traders. Roughly, if you are trading as a company, for example, you could make an arrangement with your creditors to pay them a small percentage of the debt for six months.

Kilometre rate

On 14 December IRD announced a small increase in the kilometre rate for the 2020 financial year. Tier 1, for example – 0-14,000km – has increased to 82c per kilometre. If your tax return has already been filed for the 2020 year, you can apply to IRD for a reassessment. Unless you have very high business running costs, it probably isn't worth your time to make a claim.

Part-timer sick leave

A part-timer who works say 3 days a week, is still entitled to 5 days sick leave after six months of employment. For details go to business.govt.nz

New Year's Aspirations

For many, a new year signals the start of a fresh beginning allowing goals and motivation to be reset. We typically try to leave the downsides of the prior year in the past and reassess our aspirations for the year to come. However, given the year that was 2020 and the ongoing impact of Covid-19, both locally and globally, there are various aspects of 2020 which have inevitably carried into 2021. Whilst some of these lingering effects prove to be challenging, they are not necessarily all negative.

2020 was undoubtedly a time of great uncertainty for NZ businesses. However, it was also a year in which there was a notable increase in the number of new businesses registering with the Companies Office. Data shows that at the end of December, there were 669,000 companies on record, with 58,000 registered during the year; up from 49,000 during the prior year. It is thought that the increase can in part be put down to Covid-19 related redundancies and the transformation of "side hustles" into viable businesses - something that Christchurch led project, Start Me Up is backing.

Launched earlier this year, Start Me Up is looking for business ideas from Christchurch, Ashburton and Selwyn residents whose employment was adversely impacted by Covid-19. Run in conjunction with ChristchurchNZ and the Ministry of Social Development (MSD), the two-part programme aims to teach budding entrepreneurs how to start their own business. The first part of the programme is a five-week online course designed to teach the fundamentals of building a successful business. The second part of the programme offers 25 successful applicants the chance to further develop their business idea through in-person workshops with mentors. To be eligible to apply, applicants must currently be unemployed and receiving a benefit from MSD.

The Government also recently announced the launch of its Small Business Digital Boost programme, which seeks to support small NZ business owners to realise the potential of digitising their business. The partnership between the Ministry of Business, Innovation and Employment (MBIE), The Mind Lab and Indigo will provide government-funded digital skills training and support. In the age

of the internet (and Covid-19), the ability to successfully utilise digital tools offers small businesses the opportunity to better compete in today's economic environment. The programme is the first of several that will be rolled out as part of the Government's vision for New Zealand to become a "thriving digital nation".

A shake up in the job market also looks likely with new findings revealed by Horizon Research indicating that nearly 385,000 adults will look to change their job in the coming year.

Although it is not clear if or how many of these will look to pursue their own business ideas, the support for entrepreneurs looks stronger than ever. If there was a time for a New Year's resolution and change, maybe this is it.

Crypto Gains Taxable

Inland Revenue is trying to ensure it gets tax on any gains made from purchases of crypto assets. If you have bought Bitcoin and you sell it at a profit, Inland Revenue requires you to include the gain as taxable income. The department has the same attitude to gold and silver. If you buy these assets, it's unlikely there's any other reason for the acquisition except to make a profit on the ultimate sale. Of course, it's also likely if you made a loss it would be claimable.

Parental Leave Entitlement

Some people who were on paid parental leave had to return to work for various reasons due to Covid-19. In normal circumstances, they would lose their parental leave entitlement. However, there are some circumstances in which the entitlement won't be lost. If you are affected, go to employment.govt.nz for details.

Plan for uncertain future

So you've survived the 2020 lockdown, but business might still not be where it was, or where you would like it to be.

Most businesses surviving after our lockdown have changed how they operate. They've got smarter because they had to.

Here's something worth asking yourself: What if it happens again?

We know we're only one big community transmission away from another lockdown, so what plans do you have, if any?

The fact is most businesses have just been happy to have got through it, but they haven't thought about what worked for them, how they could build on that success, and how they might survive another bout of Covid-19 disruption.

Working from home has been great for a lot of businesses. Many never thought they could do it, and believed it would involve months of planning. With only days to work it out, they found it actually did work.

Others, especially retailers, found they had to either start or beef up their online presence.

Taking these two examples, could working from home be expanded to include all staff, permanently? Could the online marketing be improved, for example by having a simple payment system, or a more streamlined packaging and delivery system?

Planning not only helps you and your business operate more effectively, but can also make the business more attractive for investors or buyers.

What did you do, and how could you improve it – now, in case Covid strikes again?

Try chat line to bypass the phone

It's difficult to communicate with some large organisations. You often have to wait through terrible music on the phone, which regularly tells you the website will have the answers you want. That's often not the case or the reason you're ringing.

Have you considered trying the chat line – if they have it – on their website? You will probably get your answer more quickly than you would if you pick up the telephone. Plus you can document the conversation by pasting into a file for later.

Tax changes for 2021

There are several tax changes for the 2021 tax year. They include:

- If you have bought an asset for your business between 17 March 2020 and 16 March 2021 the threshold for treating it as an expense has been increased from $500 to $5000. From 17 March 2021 the threshold has been increased permanently to $1000.
- Depreciation on commercial (not residential) buildings has been restored. If you have bought a building since the Government cancelled the right to claim depreciation, we will need to split the cost of the property between land and buildings. We will need evidence of their value. The rates demand could be useful.
- Please be sure to identify any wages subsidy you received due to Covid-19. The money received was not subject to GST. We will need to know how much was received by the owners of a business because that money has yet to be taxed.

TAX CALENDAR

April 7 2021

Terminal tax for 2020 (March April, May and June balance dates)
For all clients except those who have lost their extension of time privilege

7 May 2021

3rd instalment of 2021 Provisional Tax (March balance date)
GST for March 2021

28 May 2021

1st Instalment 2022 Provisional Tax (December balance date)

31 May 2021

Deadline for Fringe Benefits Tax returns

Target Returnees for Business Sales

Have you considered people wanting to come back to New Zealand as potential buyers for your business? With New Zealand considered a safe haven and so many Kiwis selling up overseas to get home, they are pushing up house prices. Many are also looking for a business to buy and being cashed-up, they have money to spend. If you're selling, think about marketing internationally and target returnees as well as potential buyers in New Zealand.