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Stephen Larsen and Co
TAX AND BUSINESS ACCOUNTANTS

Planning for Provisional Tax

Provisional tax is a way of paying your income tax as you receive income through the year. You pay instalments of income tax during the year, based on last year's income plus an estimate for the current year. The amount of provisional tax you've paid is then deducted from your tax bill at the end of the year.

If you had income tax of more than $2,500 to pay in relation to any tax year, you may have to pay provisional tax for the following year.

The number of instalments you make depends on how you calculate your provisional tax. If you're GST-registered, how often you file GST returns also affects how many instalments you make.

At the end of the year you pay or are refunded the difference between the amount of provisional tax you paid and the amount you should have paid.

There are three ways to work out your provisional tax: standard; estimation; and ratio. The option used may depend on other factors:

- If you don't choose an option, provisional tax is calculated automatically using the standard option.
- If you choose to estimate your provisional tax, you can't change to another option for that year.
- You can only use the ratio option if you're registered for GST.

The standard option uses your residual income tax (the amount of tax you have to pay) from the previous year, plus or minus 5% (depending on the year). It's paid in equal instalments during the year.

You can estimate your provisional tax for the year but if your estimate is lower than your actual residual income tax for that year, you'll be liable for interest on the underpaid amount. You can estimate your provisional tax as many times as necessary up to and including your last instalment date.

The ratio option lets you base your provisional tax payments on a percentage of your GST taxable supplies. Because you'll pay your provisional tax and GST on the same return, you'll need to file GST returns monthly or two-monthly and meet other criteria. If you want to use the ratio option you must apply to the IRD in writing or call them on 0800 377 774 before the start of the tax year when you want to use it.

Use the Provisional tax estimation (IR309) form to estimate or re-estimate your provisional tax. You can complete this form at any time up to the due date for payment of your last instalment of provisional tax

If you have cash-flow difficulties you can consider:

- making voluntary payments towards your provisional tax (this is not an instalment arrangement and penalties will still apply), and/or
- re-estimating your provisional tax liability, and/or
- using the ratio option (if you're GST-registered) to calculate your provisional tax, and/or
- requesting an instalment arrangement for payment of provisional tax.

in this issue >>>

Livestock and Herd Scheme Option

In March 2012, the government announced that all Herd Scheme elections will be irrevocable retrospectively from 18 August 2011. In order to understand how the rules for valuing livestock changed, we need to know the rules as they existed.

The Old Livestock Valuation Rules

Farmers who owned specified livestock (sheep, goats, deer, pigs, dairy and beef cattle) had options to value their animals. The two most common valuation methods are:

- Herd Scheme method; and
- National Standard Cost (NSC).

Herd Scheme method – The Herd Scheme is a value-based livestock system which values each type of livestock on the basis of age using the National Average Market Values (NAMV). The NAMVs are calculated by the pooling of various valuers throughout New Zealand who estimate the values of livestock on the 30th of April each year. The Inland Revenue then announces these values in May or June each year.

Under the Herd Scheme method, the farmer pays tax only once: on entry into the scheme. Any increase or decrease in the value of that livestock from year to year is then tax exempt. Therefore, the farmer is taxed only on the changes in the number to the livestock each year. Conversely, when livestock values fall, the losses are non-deductible.

NSC method – This method records the cost of bringing the livestock to producing age. Costs are calculated annually using a national average which is produced by the Inland Revenue in March each year. For animals bred on the farm, the national average includes an estimate of the breeding, rearing and grazing costs in the first year with a rearing and grazing cost added in subsequent years until the livestock reaches producing age.

For purchased livestock, the cost is calculated as the purchase price plus the rearing and grazing cost until the livestock reaches producing age.

How does this impact the farmers?

The NSC method usually results in a lower livestock valuation which therefore results in a lower income, and hence tax, in the first year. The farmer is not hit with a large tax impost as with a Herd Scheme method in the first year.

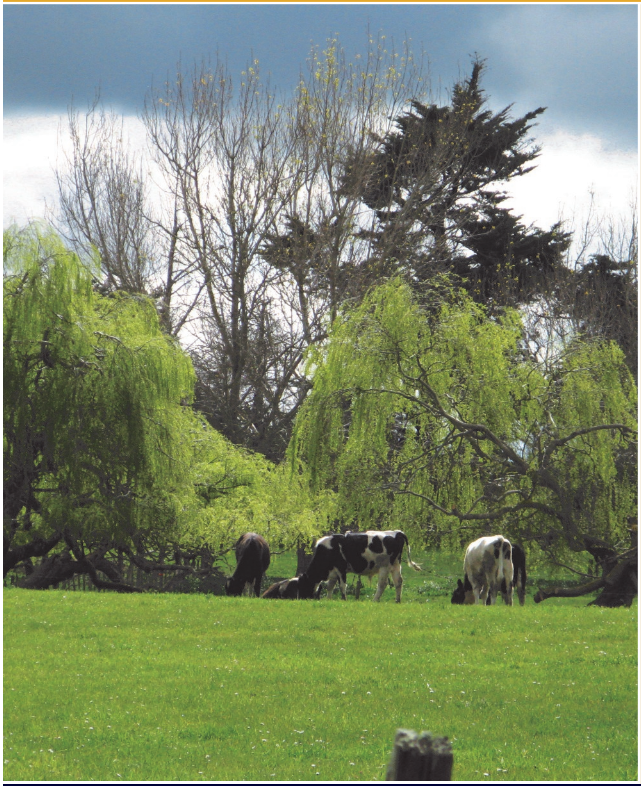
However, in the long run, the livestock values are likely to rise and because the increase in these values is tax exempt under the Herd Scheme method, farmers have a significant advantage. Another advantage that farmers have is that they are able to elect in and out of the Herd Scheme method if they wanted to.

The New Rules

What has changed is that once the farmers elect to enter the Herd Scheme method, they will not be allowed to exit the Scheme. This is effective retrospectively from 18 August 2011 (when the officials' issues paper was released). Elections to exit the herd scheme made since that date will not come into effect.

The farmers will be limited to a very few circumstances under which they can leave the Herd Scheme such as when the animals die or are sold to a non-associated party.

The 2012 Herd Values may be found at: http://www.ird.govt.nz/technical-tax/determinations/livestock/national-averages/livestock-nationalavemarketvalues-2012.html



GST Input Claim

Smaller businesses normally do not start up with flash budgets, cash-flow statements or assets required to earn income. Likewise, registering for GST is also not a prime consideration when starting out. In fact, it is not uncommon to find people starting small businesses by using their personal assets (such as a car) or tools.

When they do register for GST eventually, they may not know what or how much of GST to claim on the assets already in use.

GST input tax can be claimed on such assets using the second hand goods rules as they form part of the taxable activity. However, it is important to obtain an independent value of these assets as they are acquired from an associated person (owner) by the business. These values then form the basis on which both GST that is claimed and depreciation that can be claimed.

Whether the business claims GST on such assets or not, they have to return GST on its sale or disposal. Since they have to return output tax on the sale of these assets, it makes perfect sense to claim GST input tax when starting up with these assets.

What is Repairs and Maintenance?

Following the release of the IRD's statement on the deductibility of repairs and maintenance in Interpretation Statement IS 12/03, the details of which were released on 2 July 2012, there has been a number of queries regarding the scope of what is repairs and maintenance and where the line is now drawn. We consider a number of scenarios.

First, where repairs and maintenance form part of an overall larger project, and the costs cannot be separated out for tax purposes, the overall project must be assessed as one. Once the project is identified, the two- step approach for determining whether expenditure on repairs and maintenance is of a capital nature must be applied to the project as a whole. In Colonial Motor Co Ltd v C of IR (1994) 16 NZTC 11,361 (CA), the Court of Appeal held that expenditure incurred in converting a dilapidated warehouse into a nine-storey commercial building was not deductible, even though some of the expenditure would have related to repairs and maintenance.

Secondly, in Case F67 (1983) 6 NZTC 59,897, it was held that the taxpayer was not allowed a deduction for the cost of re-plastering, re- wiring and plumbing a building after it was affected by a fire, because the cause of the damage to the asset was irrelevant. Judge Barber identified the building as the asset, and held that the work was substantial and amounted to the reconstruction of a capital asset. Given the definition of commercial fit-out, the re-wiring and plumbing will still be depreciable, even if not immediately deductible.

Thirdly, in Ounsworth (Surveyor of Taxes) v Vickers Ltd [1915] 3 KB 267, Rowlett J considered whether a deduction was available for deferred repairs and noted that "…the real test is between expenditure which is made to meet a continuous demand, as opposed to an expenditure which is made once and for all".

The IRD confirmed that the timing of repairs is not critical, but rather, it is the nature of the work carried out and the effect of that work on the asset that is relevant.

Finally, the Court of Appeal reviewed the issue of notional repairs in Auckland Trotting Club (Inc) v C of IR [1968] NZLR 967 (CA) and noted that since the money was spent on constructing a new track, and not actually repairing it, it was not possible to treat part of the money as notionally spent on repairs when that was not what happened.

How it affects you

Contact your advisor to discuss what, if any, income tax deduction may be available on any work undertaken on an existing asset.

- From WHK's Sharp-As Tax

question time >>

Q: Do I have to pay tax if trading online?

A: You may have to…

If you're selling goods online, do you know what taxes you may have to pay? As a guide, if:

- you bought the goods with the purpose of selling them on
- the purpose was to make a profit
- your business deals in these goods

then you're regarded as being in business and should declare sales from online trading. Your tax obligations are the same as if you sold goods in a shop.

If you're in business and you use the internet as a primary or secondary sales outlet you need to account for all the sales in your income tax return. Businesses with sales of over $60,000 in any 12-month period (not necessarily all through online sales) are required to register for GST and file GST returns.

If you've been trading online for some time and think you might have tax obligations you've overlooked, contact the IRD or your advisor as soon as possible.

But if you're simply clearing out personal possessions there are generally no tax

Travel Expenditure

Again and again, we come across queries on the deductibility of travel expenditure. Travel expenses are deductible for tax purposes when they are incurred in connection with the business.

In reality, people often tag on a private holiday to a business trip especially when it is an overseas business trip. Where the trip includes both the business and holiday elements, the holiday component needs to be identified because private expenditure is not deductible.

There are no set rules to extract the private expenditure from a business trip; therefore it is important to keep sufficient records of the trip to support a claim for the business element of an overseas trip. In order to validate a claim, the Inland Revenue may request the following:

- Reason for the trip;
- Business conducted;
- Business contacts visited;
- Invoices detailing expenditure; and
- Itinerary.

If the trip is primarily for business purposes, and the private component is incidental, the full cost of airfares, accommodation and meals is generally deductible.

However, if there is a clear holiday element to the trip, it needs to be apportioned. Apportionment of the airfare is normally based on the number of business days over the total length of the trip.

Cost of accommodation and meals for only the business days will be deductible. However, if an extra night or two is required after the business is over due to the airline timetables, the cost of that accommodation would be deductible.

Quite often, the issue of deductibility arises for the costs of an accompanying spouse, companion or other family member.

The Inland Revenue will allow a deduction for the costs of an accompanying person under the following circumstances:

- The taxpayer on business must be accompanied by someone because of ill-health;
- The accompanying person is also engaged full-time in the business;
- The accompanying person contributes in some integral way to the business trip; or
- If an overseas organisation expects the taxpayer to be accompanied by a spouse e.g. for conferences.

Quick Quote

Intaxication: Euphoria at getting a refund from the IRD, which lasts until you realize it was your money to start with. ~ Adapted

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