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## Is it time to review your finance function?

To be successful, a business needs to strive for profitability and growth. An important element of this is the need to regularly review internal processes and functions. The finance function should be included in that process.

The finance function of any business needs to encapsulate the right tools, systems and processes to provide management with relevant, timely and accurate information to enable effective decision making.

Too often a business's finance function is ignored because the business continues to operate as it always has. But what may have served your business well when you had 10 customers per month, will not necessarily be fit for purpose if you now have 400 - let alone if you aspire to have 1,000.



For some, current systems may be suitable, for others an investment may be required and this may range from small changes to a major overhaul. In this process it is important to take stock of what is working well and consider what could be improved. Examples to consider include your general ledger and payroll packages and whether your finance related staff still meet your business's requirements. It may sound harsh, but the bookkeeper you hired 10 years ago (with his abacus) may no longer possess the skills you need as your business has outgrown him.

One of the biggest areas for potential improvement are 'manual' operations. Moving from manual

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processing to automated systems has many benefits. In this day and age, electronic cashbooks, Excel models and add-on's (examples are inventory management and customer relationship management) need to be considered.

There is no 'one-size-fits-all', so there should be a process of identifying the needs of your business, and preparing a wish list of information taking into account its size, turnover, growth and complexity. Different tools can then be designed to perform

different functions, some more comprehensive and complex than others.

There are many tools in the market that offer plenty of bells and whistles, so it is important to check that their cost does not outweigh the benefits they provide. Getting the right fit is essential.

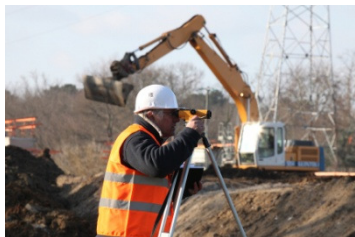
Just as you get a regular warrant of fitness for your car, your finance function should be no different.

## A lesson for us all

The "general permission" under the Income Tax Act broadly allows expenditure to be deductible if it is:

- incurred in deriving assessable income, or
- incurred in the course of carrying on a business for the purpose of deriving assessable income.

A recent Taxation Review Authority (TRA) case provides a strong reminder to us of the importance of ensuring there is a connection ('nexus') between the expenditure you deduct for tax purposes and your business or income earning process.



In TRA 008/13, a taxpayer entered into an agreement in 2006 to purchase a block of land for the development and sale of retail units and residential apartments. By June 2007 four deposit payments had been made totalling \$1.9m. Before settlement occurred, a number of conflicts arose between the vendor and the taxpayer.

Following several failed attempts by each party to cancel the agreement, they eventually went through a disputes resolution process where they agreed to split the deposit between them. The taxpayer also agreed to pay the vendor's costs (\$70,047). The taxpayer subsequently entered into an agreement to sell the plans for the project, including resource consent, for \$650,000; however the transaction was not completed.

The IRD sought to disallow \$1.4m of expenditure (including the lost deposit) incurred after 24 July 2008, when the taxpayer ceased negotiations to resurrect the agreement. The taxpayer disagreed with the IRD and the case went to the TRA.

The taxpayer argued:

- the expenditure related to a business that operated until at least December 2011,
- the agreement was entered into for the purpose of purchasing the land to derive taxable income

or alternatively to escape an onerous contract, therefore all expenses are deductible, or

- the business was operating in 2007 (the IRD agreed) and the lost deposit was deductible because it was paid at that time.

The TRA decided in the IRD's favour, concluding that from July 2008 onwards the taxpayer's focus changed from advancing the settlement of the purchase, to pulling out of the Agreement. From this point the taxpayer ceased being in business, and there was no nexus between the taxpayer's business and the expenditure.

The TRA also broadly concluded that in order to deduct expenditure to derive income, income must be derived and here there was none. It was further stated that the taxpayer intended to acquire and sell full legal title to the land. However, the taxpayer only acquired an equitable interest in the land. The implication being that the taxpayer's intention when the due diligence clause was fulfilled was not to sell an equitable interest, therefore there was no requisite intention of resale in respect of the interest that was acquired.

The TRA took the view that the settlement amount was paid from the deposit monies held by the taxpayers' lawyer as a stakeholder; it was not payment of the deposit.

The IRD not only denied the deductions, but also charged a \$39,194 shortfall penalty for taking an unacceptable tax position.

Decisions like this are unsettling because at face value, it would seem reasonable to claim a deduction for the expenditure. Especially given, if income had been derived, the expenditure is likely to have been deductible.

The lesson here is to think carefully about situations that may be outside 'the norm'. Even if intuitively an expense appears deductible, it may not be. In these situations, a quick phone call to your advisor would be a good idea.

## Valuing diversity

There is a convincing argument that diversity within an organisation leads to better decision-making, innovation and business performance. For many entities, diversity has become a business imperative critical to the success of their strategic goals. As New Zealand's demographic continues to change, business leaders must embrace diversity and recognise its benefits by understanding how it affects their relationships and ability to perform in the market.

Diversity refers to the variety of differences between people within an organisation and encompasses race, religion, language, age, personality, cognitive style, education, background and more. Each year our demographic becomes more diverse and more multicultural, which impacts the workforce and our customers. Effectively managing this change is key to an organisation's ability to adapt and thrive.

### Benefits of diversity

By bringing a team of diverse people together, an entity can strengthen its ability to respond to changing conditions, and improve its ability to anticipate and meet customer needs and expectations.

Diversity can lead to new and interesting ideas. Employees who feel comfortable communicating their different viewpoints can help add to the pool of ideas contributing to strategic needs.

Workplace diversity can also increase an entity's range of services and customer network. The diverse skills and experiences brought out by different employees (such as languages and cultural understanding) can allow a company to provide services to previously untapped customer segments and markets.



### So what can your business do to increase diversity?

Start by creating an attitude of openness in your organisation. Encourage employees to share their ideas and opinions and provide a sense of equal value to all. This awareness will help drive change.

In order to maximise the competitive advantage of becoming more diverse, you must identify what your business needs are. Reflect on how the competitive and customer landscape has changed over the past three to five years and consider what things might look like in the future. For example, has there been a change in the mix of your employees and your customer base and the communities that you serve? Do your employees reflect the demographic that you serve or want to serve? If not, develop a hiring strategy to increase workforce diversity.

At the same time, provide diversity training in your workplace to ensure that all employees understand hiring decisions are based on finding the best candidate to match the needs of the business and not political correctness. Transparency is important to keep employees' minds at ease. Managers also need to understand the benefits of a diverse workplace as they will be involved in implementing the policies.

Aim to promote and bring diversity into the leadership positions of your organisation. This will create visibility and enable the benefits to be realised.

And finally, to get the best out of your employees they need to feel able to bring the whole of themselves to work. Create a culture that values and respects differences. Encourage staff to be themselves, to be different.

## Attribution of personal services income

Many people aren't aware that specific tax rules exist that can deem income derived by a company or trust to be derived by them personally. The rules were first introduced when the 39% tax rate was introduced to stop people getting a tax advantage by trading through a company or trust to access the lower 33% tax rate. Although the top personal marginal tax rate has been reduced to 33%, the company rate is lower at 28%, and hence the rules are still active and need to be kept in mind.

Income is attributed when:

- 80% or more of the entity's income from personal services is derived from services

personally performed by an associated person or a relative,

- 80% or more of the entity's income from personal services is derived from the sale of services to a customer or a person associated with the customer,
- the person's net income for the income year exceeds \$70,000, including any amounts available for attribution, and
- substantial business assets (as defined below) are not a necessary part of the business structure used to derive the entity's assessable income.

“Substantial business assets” are depreciable property that cost more than \$75,000 or, make up at least 25% of the associated entity’s total assessable income from services for the income year and are not for private use.

When a person first sets up business, it may be that the rules don’t apply. But experience has shown that circumstances change over time and those changes can mean someone drops into the ambit of the rules, without realising it. For example, Jenny and Harry are a brother and sister team that went into business together. Jenny is an interior designer and Harry is an architect. They are employed by a company in which they each own 50% of the shares. The Company receives income from the services they perform.



Jenny decides she wants a change of scenery and sells up and moves to New York to become an actress. Harry buys Jenny’s 50% share in the Company.

Harry subsequently wins a large contract with Fletcher Construction that provides more than 80% of the company’s income for the following six months and the contract is later extended.

In this scenario, the income derived by the company from personal services performed by Harry is likely to be subject to the 'attribution rules'. Under the attribution rules, the net personal services income derived by the Company will be attributed to Harry. If net income of \$180,000 were attributed directly to Harry and subject to tax at the top marginal tax rate (33% as opposed to the 28% company tax rate), additional tax of \$9,000 would be payable.

The IRD’s intention is to ensure that taxpayers like Harry cannot avoid the highest personal tax rate (currently 33%). Increasingly more resources are being put into this area to ensure taxpayers are returning the appropriate amount of tax, so if you think the attribution rules may apply to you, please seek professional advice.

## Snippets

### International measures to prevent tax evasion

When some individuals move overseas they stop fulfilling their NZ tax obligations (e.g. student loans and child support).

In 2012 NZ signed up to The Convention on Mutual Administrative Assistance in Tax Matters, however it only came into effect for NZ from 1 January 2015. As a result of the agreement, the IRD’s ability to find and pursue tax evasion and tax debts internationally has been strengthened.

0110	Frankfurt	QF 5	C24	
2320	London-Heathw	BA 16	C18	Gate Closed
2325	Tokyo-Narita	NH 902	D35	Gate Closed
2325	London-Heathw	QF 9	C13	Gate Closing
2330	Paris-CDG	DL 8377	C22	Gate Closed
2330	Tokyo-Narita	AA 5832	D44	Gate Closed
2355	Osaka/Kansai	JL 722	D40	Gate Closing
0130	London-Heathw	QF 31	C26	
0015	Beijing	CA 970	D30	Boarding
0050	Moscow-DomodUN	516	C23	Gate Open

The Agreement provides for administrative assistance in the assessment and collection of taxes between tax authorities who have signed up to the Convention (currently 84 countries). The IRD can now seek assistance from other tax authorities also signed up to the convention.

This reinforces the need for people to be aware of and meet their tax obligations irrespective of where they happen to move to.

### Terrible excuses for missing tax return deadlines

The due date for filing tax returns seems to creep up on us and sometimes it comes and goes so quickly that before you know it you’ve missed it. Valid excuses may help escape late filing penalties,

however we often just have to bite the bullet and pay the penalty.

The UK’s HM Revenue & Customs (HMRC) has revealed the top 10 worst excuses that taxpayers have provided for missing the tax return deadline:

- "My pet dog ate my tax return.....and all the reminders"
- "I was up a mountain in Wales, and couldn't find a post-box or get an internet signal"
- "I fell in with the wrong crowd"
- "I've been travelling the world, trying to escape from a foreign intelligence agency"
- "Barack Obama is in charge of my finances"
- "I've been busy looking after a flock of escaped parrots and some fox cubs"
- "A work colleague borrowed my tax return, to photocopy it, and didn't give it back"
- "I live in a camper van in a supermarket car park"
- "My girlfriend's pregnant"
- "I was in Australia"



The HMRC states that "people can have a genuine excuse for missing a tax deadline, but owning a pet with a taste for HMRC envelopes isn't one of them."



## 2015 FINANCIAL YEAR

For most taxpayers the end of March represents the end of the financial year.

We will again be using on-line client questionnaires which will be e.mailed to clients in early April, 2015 for those with e.mail addresses, or posting out paper versions.

Existing clients who have had these questionnaires in prior years will automatically have information pre-populated on this years form, which should save you time by only having to check that the details are still correct.

With March, 2015, fast approaching it is also a good opportunity to ensure your records are in order and also to review the following:

1. Bad Debts – review all debtors, and if you have doubts as to whether the debts are collectable, they should be written off **prior to** the 31 March in order to be able to get a deduction.
2. Assets – any equipment purchased during the year costing over \$500 will need to be capitalised. It is beneficial to provide a schedule of such assets with copies of invoices with your records.
3. Holiday Pay – In order to obtain a deduction for accrued holiday pay or employee bonuses, payments must be incurred with 63 days of balance date ie by 2<sup>nd</sup> June, 2015.
4. Stock on Hand – Put plans in place to ensure that an accurate count of stock on hand is completed at 31 March.
5. In April, 2015, complete schedules of Accounts Receivable and Accounts Payable.
6. Complete a bank reconciliation detailing any outstanding cheques and deposits, and print a copy to bring in with you records. Ensure that the reconciliation is to the last day of your financial year, and not just to the end of the Bank Statement.
7. Obtain copies of investment and loan statements as at balance date
8. Take copies of GST Returns with associated working papers **for the period to 31 March, 2015**, and include with your records.

If you have any questions regarding the end of the financial year, we would be happy to help.

## CONGRATULATIONS

On the 15th February, 2015, Olive Low celebrated her 100th birthday at Summervale Village at Mount Maunganui, with 'Champagne at Elevesens'.

Olive has been a client of our firm for many many years, (and has completed a lot of those dreaded questionnaires which we send out each year).

Olive's morning started well with a beautiful day dawning, and cards delivered from Queen Elizabeth and Prime Minister, John Key.

She enjoyed a spin around Mount Maunganui in a vintage car, before spending time with friends and family for champagne, nibbles and a birthday cake.

It was a privilege to be able to share this special day with Olive, and see the photos and hear the stories of her life, including her time as a Tui in World War II in Cairo with the Womens War Service Auxiliary.

Congratulations Olive on such a mile stone and we wish you many more birthdays to come.



*If you have any questions about the newsletter items, please contact us, we are here to help.*