

CST Nexia News

From the Managing Partner's Desk

Welcome to our Spring edition of CST Nexia News for 2010, although with all the snow and rain we had throughout the country during September, you wouldn't think it was Spring time just yet!

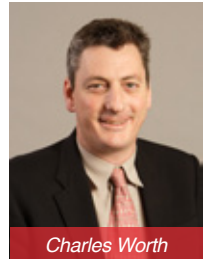
We have some very interesting articles to share with you in this edition. I would like to congratulate Tania Styles (our Tax Manager) who competed in the 'Tough Guy' challenge in August, in very muddy conditions! You can read all about it in Tania's article below. Our tax update will also be of interest to you. Several of the changes outlined in the May budget are coming into effect at present and we have summarised some key points on page four. Please contact us if

you have any queries about any of the subjects raised.

In recent months we have farewelled some staff members here at CST Nexia and also welcomed some fantastic new members to the team who I'm sure some of you have met and spoken with already, and who bring a great amount of skill and knowledge to the company.

As we head into the last quarter of 2010, I'm sure we are all reflecting on the year now behind us and I'm hopeful things are continuing to improve for you all. As the summer months draw closer, we can look forward to the SRAM Tour de Ranges on Saturday 22nd January 2011 that CST Nexia are sponsoring. The Tour de Ranges is a 110km cycle race that starts

and finishes in Clevedon (40 minutes drive south of Auckland), and does one complete lap of the Hunua Ranges, taking in the towns of Hunua, Mangatawhiri, Kaiaua and Kawakawa Bay. For those of us who would prefer a less demanding ride, there is also a 30km race to take part in. Please see our website www.cstnexus.co.nz for more information, and we will be in contact in the coming weeks to provide further details. ■



Charles Worth

Mud, Glorious Mud!

I was persuaded to compete in the recent Tough Guy and Gal Challenge in Rotorua – luckily only the 6km. It comprises running up and down hills, army type obstacles and mud swamps - up to your neck in places. If I had of known all the details I probably wouldn't have agreed to do it! The joy of hindsight huh!

Well it certainly was a challenge, and an experience I will never forget. I managed to fall over in the very first bog hole and was muddy up to my chin. After getting through the 6km course, the "tough" experience continued with a very long cold wait to get hosed down by a cold fire hose before you could even compete for a hot shower – of which there weren't many (around a dozen) compared to the over 2,000 competitors. The

saving grace was the hot pools which many jumped in still in their thermals! I don't think the pools are ever going to be the same again.

I am not sure if I will be back next year, I may be persuaded if there's a campervan and hot shower waiting for me! But I do highly recommend it as an experience.

But I finished! I finished in the top half out of all the 6km course competitors. In my age group for women I finished 67/240 which I was quite happy with as I'm certainly no super-athlete.

For more pics and event info you can go to www.toughguyandgal.co.nz ■

Tania Styles
 Tax Manager



HR Corner - Social Networking Policies

The media has reported various incidents of employees being dismissed for making derogatory comments about their employers using sites such as Facebook. This is relatively new to New Zealand and justification of a dismissal over

their use has not yet been tested by the New Zealand employment courts.

It is however recommended that employers develop policies on the use of social networking sites. Policies should include all blogging that

affects the business outside of work time and on a work or private computer. The main risks the employer needs to be aware of are:

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- Derogatory comments about the employer, other employees, clients or suppliers;
- Postings which bring the company into disrepute;
- Disclosure of confidential information



Workplace Literacy

- Do you have an employee who has difficulty:
- Reading and understanding a memo or instruction manual?
 - Making sense of a graph or chart?
 - Working out weights and quantities?

This can cause mistakes, wastage, accidents, injuries, missed deadlines and inefficiency. Primarily for employers the Skills Highway programme (www.skillshighway.govt.nz) aims to help more businesses start to provide workplace literacy training to address these issues. The information available helps provide effective training whatever the size or the need and includes free tools and resources to download and an online indicator to identify skill gaps. Many businesses may find this a useful way to

help employees up skill in this area. If you need help regarding these or any other HR related issues please call me on (09) 261-1392 Monday, Wednesday and Friday of each week. ■

Deirdre Little
HR Manager



Monitor Solvency So You Don't Get Into Difficulties

In the current economic circumstances business owners and managers should be monitoring their business' solvency so as to avoid potential problems. Signs of potential insolvency include:

- Declining profit margins - leaders should be conscious of gross profit percentages and net profit percentages
- Declining cash flow - this can be caused by delay in payments from debtors; demand from creditors for earlier payments; build-up in stock and work-in-progress levels; or unnecessary capital expenditure
- A high level of staff turnover can be a clue of some financial instability in the business
- Creditors putting a stop on supplies - can be a real indicator that something is wrong with the business
- A never decreasing bank overdraft is also a danger sign
- Loss of a major customer can cause instability in the business
- Falling behind in payments of GST and income tax
- Incurring interest on credit card balances
- Paying creditors well beyond their stated terms of

trade can highlight financial problems and could be very dangerous if the creditor stops supply and demands immediate payment



If any of these problems are occurring in the business, the earlier the business asks their accountants for a full review of business activities, the better, so that a policy can be determined, including:

- Full diagnostic review of the business
- Review of debtors, stock and work-in-progress levels

- Review of creditors to determine days taken to make payments compared to creditors' terms of trade
- Update or preparation of a business plan which outlines the business' strategies for successful trading over the next 12 months. This will include budget and cash flow projections

The key thing for the business leader to do is to take action and not sit in the hope that the situation will improve itself. This will mean maintaining relationships with the bank and keeping the bank informed; talking to key customers and entering into realistic payment arrangements with suppliers; keeping team members informed so that they are able to answer comments being made to them by customers and suppliers; and at the same time, continue to be outstanding ambassadors for the business. If things are 'off the rails', accept that changes are necessary even though some of them may be painful.

If you have any concerns about your business' performance in the current circumstances please contact us. ■

Capital Raising

Many public companies have been raising new capital to replenish their reserves following trading difficulties during the global financial crisis. Many small/medium enterprises will also be looking to raise additional loan funds or capital to be able to exploit the expected market opportunities as trading conditions improve.

Banks are imposing financial stress testing to any new loan applications, which means SMEs need to carefully prepare loan applications. The



upturn in business confidence has encouraged some Business Angels to start re-evaluating proposals for capital investments in some small/medium enterprises. If you are trying to raise a substantial loan or capital from Business Angel investors, your business application will be enhanced if the appropriate planning strategies have been implemented so as to professionalise the approach being made to potential investors or lenders.

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The company has to be able to exhibit that it has developed a product/service that the market needs. You will need to be able to answer the following questions:

- What problems are solved by the product/service or technology?
- How is it different from competitors' products/services or technologies?
- What is the stage of development?
- What is the sustainable competitive advantage?
- How will the products succeed in the market?

- What testimonials can be produced from current customers?
- Is the product/service or technology already available in the market place and is there further research to be undertaken?
- Has an independent technical assessment on the product/service or technology been conducted?
- Is it a standalone product/service or technology or will it form part of a product stream?
- How is the intellectual property protected?
- What market research analysis has been undertaken?
- What is the WOW factor?

- Who are the members of the management team?
- What is the management team's experience? It is a good idea to attach the management team's CVs to a funding application.
- Who are the directors of the business? (especially if they are different to the management team)

There are many aspects to consider in completing applications for large loans or capital raising strategies for SMEs. If you would like to discuss this with us, please do not hesitate to contact us. ■

Never Let Tax Get In The Way Of A Sound Business Decision Depreciation Deductibility On Residential Property Investment



Robert Willis

One of the most important rules any tax advisor should learn, is to never let tax outcomes get in the way of a business decision. Firstly, the deal has to stack up on its own. Tax benefits and costs are secondary.

Recent changes to the way property will be taxed have

led to much discussion as to the fairness for the property investor. Some are considering selling their properties as they expect the tax burden will be increased so much that holding onto the property will become uneconomic. This specifically relates to depreciation deductibility for tax purposes on residential property.

In most cases depreciation is just a tax deferral as most properties will sell for more than what they cost, causing depreciation recovery - taxable in the year of sale. What is claimed as a deduction over the years of ownership is given back on sale.

The only benefit of depreciation over the year is a savings in tax, allowing slightly increased debt repayments or cash in the bank. The benefit is the time value of these funds - the tax saved yet to be returned to IRD as tax on depreciation recovery.

The biggest prize from property ownership is clearly an increase in value - the main business consideration that drives most investors to make their investment decisions.

A review of Real Estate Institute New Zealand figures for average residential sales values of properties over the past 10 years has shown an increase in Auckland of 87% and the rest of New Zealand an increase of 110%. Over the same period, the time value of money saved from depreciation deductions amounted to only 1.8% of the increase in property value for Auckland and 1.6% of the increase in property value for the rest of New Zealand. The Auckland increase was \$211,443 and the time value of money \$3,877, the rest of New Zealand \$166,541 and \$2,651 respectively. ¹

This clearly reinforces the old adage that tax should not influence a business decision.

¹Information provided by Quotable Value Limited.

It is proven that the return from investing in property for a period of time significantly outweighs any tax consequences that will follow from property investors being denied a depreciation deduction, if New Zealand experiences similar increases in property prices in the future.

For those who are selling their property as the tax consequences have driven them to it are likely to be making that decision for all the wrong reasons. ■



Business Risk – Giving Personal Guarantees

We all do it. Often it is the only way to get trade credit with some trade suppliers. Giving these guarantees is never a problem when things are going well, but when times are tough, or the business fails, then personal guarantees become a real problem and erode personal assets.

The trouble is, over the lifetime of being in business, we probably do not record adequately what guarantees we have out there, which has the ability to tip us over the edge in the event of a business failure or a dispute.

So how do we figure out what personal guarantees are out there? Knowing this is critical to ongoing business relationships, especially when there are alternative suppliers who would be pleased to do business with you or the guarantee you gave 10 years ago might now be cancelled or restricted.

Your bank is keen to know the extent of your personal liability, as it could have an impact of the value of any guarantee you may give them.

We advise clients to find out what guarantees are out there, in order to manage this business risk.

We suggest this simple process, on a basis of tidying up your internal documentation:

1. Call or write to all trade suppliers stating you are updating your files with all preferred trade suppliers and require up-to-date terms and conditions of trade.
2. Ask for them to send you a copy of any personal guarantees or security they may hold over you and your fellow Directors personally or over your company.

A suggested script to send to trade suppliers could be as follows:

"We are currently updating our files on current terms of trade. As a preferred supplier to our company, we would be grateful if you would forward a printed copy of your current terms of trade. We would be grateful if you would also forward a copy of any personal guarantees (if any) or other security you hold that

relates to this account for supply of goods on credit."

In the event an old personal guarantee arises from several years ago, you can then decide what to do. Either close the account and deal with another supplier who does not require any personal guarantee, or negotiate your release from the guarantee if the business is to continue.

If one fuel company has your guarantee, there are at least 3 others who you could deal with on more favourable terms.

In the event you are not able to get released from this obligation, management of this account should be a priority, for example, never let payments on this account get behind.

Going forward, maintain a register of any personal or company guarantees or other forms of security given to trade suppliers. ■

Robert Willis

Tax update – October 2010



Tania Styles

There is never a shortage of tax related items to talk about as tax is always changing.

The Budget in May seems a distant memory but a lot of the changes outlined are about to come into effect. However some areas are yet to be finalised such as the changes to Loss Attributing Qualifying Companies (“LAQC”). It is expected that some draft legislation in the LAQC area will be issued by November.

Tax Avoidance -

Penny and Hooper Case

Those of you who provide professional services will likely have a particular interest in this case. Recently, the decision of the Court of Appeal was announced in favour of the IRD. However, the taxpayers have appealed to the Supreme Court.

The case concerned two orthopedic surgeons who practiced in both the public and private sector and who restructured their business affairs, moving from operating as sole traders to using companies. The shares in the companies were held by family trusts. The surgeons were employees of the companies and received salaries but the majority of the profits were paid to the trust's shareholders as dividend income, thus reducing the tax position compared to if the income was taxed in the surgeons' hands as sole traders.

The Court found that the restructuring, along with payment of non-market salaries, was tax avoidance.

Some of the key points from the Court of Appeal decision are set out below:

- A company with trust shareholders is a perfectly acceptable structure to operate from. However, the entire arrangement must be considered on its commercial reality. In this case, it was considered the restructure was contrived and had a dominant purpose of reducing tax.
- The main point with regard to the restructuring being contrived was that their salaries significantly reduced after the restructure but the same business activities continued as they had when the business operated as a sole trader business. The surgeons accepted that the salaries were lower than what they would have been had they been employed independently at arms length.

So taxpayers are able to choose the structure though which to operate from but it does beg the question as to what level of salary would be acceptable. The Court noted that there will be valid reasons for paying out a low salary, such as where the company is making a loss, where the company is in a start up phase or reserving funds for capital expenditure.

IRD has issued a Revenue Alert RA 10/01 outlining their current position on the matter

of tax avoidance. You can access this from the IRD website or by contacting us for a copy. It is important to note that just because you operate via a company or trust structure as a personal service provider does not necessarily mean tax avoidance will exist.

Clarification of Item in June Tax Update

In the June update we referred to the “automatic deduction” of legal fees under \$10,000 without needing to consider if they are on capital account. It should be noted that you do still need to meet the general permission i.e. that the expense was incurred in deriving your income or carrying on a business.

Income Sharing Tax Credit Proposal

A bill has been recently tabled in Parliament proposing a tax credit for eligible couples caring for children. Basically, a tax credit would be calculated for eligible couples on the difference between their combined tax as individuals and the tax they would pay if that income was split 50/50. It would not affect child support or student loan repayments. The credit will only apply where the partners face a different marginal tax rate on their income. The maximum credit will be \$9,080, losses will be ignored, and special rules will apply if the tax on income earned is for other than 12 months. We will update you on the progress of this bill.

GST Rate Change on 1 October

We outline below some of the key points around the rate increase from 12.5% to 15% from 1 October 2010:

Time of Supply (“TOS”)

Time of supply is the cornerstone of the GST legislation. In most cases, the TOS is what will determine if the GST rate should be 12.5% or 15%. Once a supply of goods or services has occurred, time of supply is triggered by

the earlier of the:

- issuing of an invoice, or
- payment

Note that an invoice is a document notifying an obligation to make payment rather than being a “Tax invoice”. A property sale and purchase agreement does not on its own constitute an invoice.

Calculation

To get the GST component of a GST inclusive amount, you will now need to multiply by 3/23 rather than dividing by 9. This is more accurate than dividing by 7.66666.

Special Rules

Special rules apply to continuous supplies, laybys, second hand goods claims, transactions between associated persons and changes of use. If any of these apply to you we suggest you contact us shortly to discuss this further to ensure you

apply the correct treatment.

Transitional Returns

If your GST return spans the 30 September period, you will receive 2 returns – one from the beginning of your return period up until 30 September and one from 1 October until the end of your return period.

Adjustment Required By All

Payments Basis Taxpayers

If you file your returns on a payments basis, you will need to include an adjustment in your GST return period ending on 30 September.

You will need to perform a calculation of what debtors (invoices you have issued) and creditors (invoices you have received) you have at 30 September. This adjustment is necessary as when you later receive or make payment you will be returning or claiming at the 15% GST rate. The adjustment means that overall you are returning or claiming at the 12.5% rate because the “supply” occurred prior to the rate change.

IRD's approach

IRD will take a reasonable approach on charging of interest and penalties where taxpayers get their returns wrong. However, if you prepare your own GST return and would like peace of mind, CST would be happy to discuss reviewing your return prior to you filing. If you wish us to review your return please contact us as soon as possible to discuss.

Private Training Establishments

Specific legislative changes have been made for Private Training Establishments (“PTE’S”) which would allow PTE’s to obtain a tax credit to cover the difference between the old and new GST rates for tuition fees outstanding at 30 September 2010. Please contact us if you require further information on this.

GST and Property Transactions

A bill has been introduced proposing to zero-rate GST on land transactions between GST registered persons. This eliminates the GST refund that would otherwise have arisen for the purchaser, as well as the GST payment required by the vendor.

The change has been driven by Phoenix style arrangements where a GST input tax credit is claimed but the vendor never accounts for the GST output tax and subsequently liquidates. This prevents erosion of the tax base.

Once implemented, the change will impose obligations on the vendor where they will be required to obtain the purchaser's registration details as well as the purchaser's intention to ensure the property will remain within the GST net.

We will update you on progress of this bill. ■

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