BIZTAX ALERT

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Risk and Reward

Remuneration of shareholder employees

The *Penny and Hooper* decision is a landmark tax avoidance case that has implications for small businesses operating through a company or trust. Essentially, the Supreme Court decided in favour of Inland Revenue, concluding that setting artificially low salaries amounted to tax avoidance.

Penny and Hooper were two orthopaedic surgeons, each earning taxable income of between $600k and $850k a year. They restructured their businesses into companies with a family trust owning most of the shares. They provided their services to the companies in return for salaries of $100k - $120k each year. The balance of the company's income was declared as dividends to the family trust which the surgeons drew from regularly.

Each year tax of between $20k and $30k was saved by having the profits after salaries taxed at the trustee rate rather than at the surgeons' individual top personal tax rates. The court found these savings a 'more than merely incidental' reason for their low salaries.

The IRD has put businesses on alert and is actively reviewing those operating through a company or trust where the income is generated from services provided by an individual, and the individual's salary is unreasonably low. Although there may be good reasons for setting the salary low in a particular year, e.g. adverse business conditions, or a planned expansion of the business, in some cases the sole reason for the salary level is to take advantage of the lower tax rate that applies to companies.

The IRD is entitled to go back four years into a business' records, but have publicly confirmed that where a 'voluntary disclosure' is made, only the last two income tax returns will be reassessed. A voluntary disclosure might significantly reduce IRD penalties or avoid them entirely.

Whenever we're discussing your business we'll look at this for you. In the meantime, if you are concerned and would like to discuss this with us, please do contact us.

ACC changes self-employed invoicing

ACC has recently changed the way it invoices self-employed clients with regard to their full or part-time status, dependent on whether you work 30 hours or more a week.

Information on your full or part-time status no longer flows through to ACC's database on the IRD IR3 form. If you held part-time status last year and this year your earnings crossed the threshold you will receive a letter from ACC automatically confirming your change to full-time status. In all other scenarios it is up to you to formally confirm a change of status with ACC.

It would pay to check your invoice this year and call us if there's any confusion. Clients could get stung, for instance, if they have been paying levies on the basis of part-time status, have an accident, and then declare full-time status. In such a case ACC may query it and can backdate levies up to four years.

We are soon to provide an ongoing ACC administration and advisory service to our clients on an agreed annual fee basis. Being recognised by ACC as your online agent gives us secure online access to your levy information, your cover status and invoices, allowing us to work directly with ACC. A simple signed authority from you and we'd be happy to review your cover structure and premiums, to ensure your cover is appropriate and levies are minimised.

Tax Talk

Working For Families

From April 1 2012 many of the small changes to Working For Families signalled last year come into effect:

- The family tax credit amount for children under 16 will rise for inflation:

Qualifying Child	Current amount	New amount
First child under 16	$4,578	**$4,822**
Second child if under 13	$3,182	**$3,351**
Second child if 13 - 15	$3,629	**$3,822**

- The net income level guaranteed by the minimum family tax credit will rise from $22,204 to $22,568
- The abatement rate will increase from 20 to 21.25 cents in the dollar
- The abatement threshold will decrease from $36,827 to $36,350

KiwiSaver

As of 1 April 2012 employer contributions will no longer be tax free. Employer Superannuation Contribution Tax will apply at the employee's marginal tax rate.

Minimum wage

As of 1 April 2012 the minimum wage will increase from $13.00 per hour to $13.50 per hour.

Training and new entrants' minimum wages will increase from $10.40 to $10.80 - 80 per cent of the adult minimum wage.

New GST rules for multi-use assets

New rules came into effect 1 April last year replacing the old change-in-use rules by apportioning input tax deductions in line with the actual use of the goods and services. As the 2012 financial year closes, the new rules will be applied for goods and services acquired on or after 1 April 2011. In subsequent periods, when a change to the actual taxable use occurs, from what was first intended, a GST adjustment within an adjustment period must be made (a number of exemptions may apply).

There is a maximum number of adjustment periods according to the asset's value or estimated useful life and special 'wash-up' rules apply when goods and services that have been subject to the apportionment rules are sold or the person deregisters.

Tax pooling

In some cases you may be able to save more than 25% of IRD's interest cost on your provisional tax. All with the seal of approval of the IRD.

If a company or trust pays insufficient provisional tax during a year IRD charge interest. The current rate is 8.89% pa.

Tax pooling is a service introduced by Inland Revenue that allows provisional taxpayers to reduce their exposure to IRD interest costs.

How it works: When we have finished your income tax return, we inform you whether you owe any further tax to IRD. In many cases, you will also owe IRD interest.

Tax pooling allows you to buy tax credits that other taxpayers do not need. These tax credits have already been paid to IRD, but through the tax pool can be transferred from the seller to you. The cost of buying those credits is substantially less than paying IRD interest.

The table below shows the savings you can make on 2011 underpaid provisional tax if purchased in March 2012.

Underpaid Provisional Tax	Estimated Savings
$10,000	$268
$20,000	$536
$30,000	$803
$50,000	$1,338
$100,000	$2,675

We can arrange a tax purchase on your behalf as we work closely with NZ's leading tax pooling company, Tax Management NZ. For small amounts however it may not warrant the time involved in setting up the arrangement.

Death and taxes may be inevitable, but they shouldn't be related. **J.C. Watts, Jr.**