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## Client Newsletter

### Bright-line test for gains on property

The bright-line test introduced last year requires income tax to be paid on any gains from property purchased and sold within a two year period, though there are some exceptions.

The objective is to improve compliance with the current residential land sale rules and ensure that property owners pay their fair share of tax on gains made from residential property sales.

To assist with the application of the legislation, many terms were defined in the enacted Taxation (Bright-line Test for Residential Land) Act, the more important ones which are explained below.

1. Exceptions include the sale of an owner's main home (as defined), inherited property, or property transferred in a relationship settlement.
2. The start and end of the two-year bright-line period starts when a person obtains registered title for the property and ends when the person enters into an agreement to sell the property.
3. All existing property will be '*grand parented*' ie any sale of property purchased before 1 October 2015 will not be subject to the bright-line rules.
4. Losses arising under the bright-line test will be '*ring-fenced*' meaning the losses can only be used to offset gains from the sale of another property. The Act also includes an anti-avoidance rule to prevent companies or trusts being used to circumvent the test.
5. There is an additional rule for '*off the plan*' purchases – if a bare section in a planned subdivision capable of having a dwelling erected on it is sold within the relevant 2-year period, the bright-line test applies. The period for '*off the plan*' sales apply from the entering into of the contract to buy until the entering into of the contract to sell.
6. Where an investment property is transferred under a relationship settlement to one party and that party then sells within two years of its purchase, it will be subject to the bright-line test as it would have been owned by that party, either jointly or solely, for two years.
7. Where an investment property is purchased for a mixed use, for example a small dwelling on the top floor which is rented out and a larger ground floor shop from which business operations are carried out and is subsequently sold within the two years, the gain will not be subject to the bright-line test because the property was predominantly used as business premises.
8. Farmland is not included in the bright-line test but a lifestyle block is which is not capable of being farmed as an economic unit due to its small size.

### Employing the Right People

While deciding to employ others to work in a business can become a necessity if the business is to survive and grow, it is nevertheless a big step for any business. And at this critical time, these are some questions you need to ask about the type of person that is needed:

- How much work there is?
- Is there a deadline for this work - when does the work needs to be completed?

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- What are the different types of staffing options and what suits my business?
- Do I need an employee or a contractor?
- What are the rules are around the different employee types.

## Overview of different employee types

Type	Suitable when:
1. Permanent	there is ongoing work which is expected to continue indefinitely, whether it is full-time or part-time. Wages and conditions of work must be formalised in an employment contract.
2. Fixed Term	hiring for a specific period eg to cover the workload of an employee on maternity leave or for a specified project. The fixed term agreement must clearly state the dates and reason for the employment.
3. Casual	a business needs extra help with uncertain hours to which casual workers are most suited. Although only hired when needed, they are still entitled to paid leave which is usually added at 8% to their wages.

## Employees vs Contractors

### Employees

Employees are people who work for you. You provide them with an employment agreement and the equipment they need to do their job. Employees are entitled to a range of minimum standards, including holiday pay, receiving at least the adult minimum wage and paid public holidays with time off. Employers also pay less obvious costs involved such as recruitment, training & development, office space and equipment, KiwiSaver contributions, ACC levies, FBT etc... You are responsible for registering as an employer with Inland Revenue and telling them the employees' start date, deducting PAYE from their salary/wages and paying it to IRD, and paying annual ACC levies.

### Contractors

Contractors are self-employed. They control what work they accept. They have special skills or knowledge which the business may need for a limited time to complete a specific piece of work. Contractors sort out their own obligations with Inland Revenue and ACC, and provide their own equipment to complete the work they've been signed on to do.

### Which is best?

Be clear about your expectations and what is suitable for the role and then determine which option is best. Don't be tempted to use a contractor simply to avoid financial commitments particularly where appointing a permanent employee could take your business to a whole new level. The following sets out the important differences between the two.

#### Employees

Work for you directly and told what to do, when to do it, and how to do it.

Work a set number of hours per week or month, and get paid overtime when they work extra hours.

Work where you tell them to using equipment you provide.

Have an employment agreement with you.

Require employers to pay their PAYE and KiwiSaver for them.

#### Contractors

Decide when and how they do the work and can employ other people to help them finish it.

Are responsible for getting the work done to the required standard in the agreed time frame.

Generally take care of their own assets and equipment.

Advertise their services and are free to work for other people.

Pay their own income tax, KiwiSaver and ACC levies.

Important: This is not advice. Clients should not act solely on the basis of the material contained in the Client Newsletter. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The Client Newsletter is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval. 01/2016.

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# The Special Bulletin

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## End-of-year tax information checklist

It's that time of the year again when you'll need to start gathering together your accounting and tax information for the year ended 31 March 2016.

Set out below is a list of items that will assist you with this process, and remind you of some of your tax obligations.

### Penalties regime

There is a mandatory 'shortfall' penalties regime in place – the penalties range from 20-150%. These penalties cannot be remitted. The rate of shortfall penalties may be reduced for previous good behaviour.

Examples of where automatic penalties will be applied include when:

- Motor vehicle logbooks are not kept. (If you are self-employed, a logbook must be kept for a 3-month period every 3 years).

Please check that your work-related vehicles still meet the criteria, otherwise fringe benefit tax may be applicable.

- Stocksheets are not kept, or a stocktake is not physically taken.
- Bad debts are not physically written off before 31 March 2015.
- Tax on schedular payments (formerly withholding tax) is not deducted from contractors, unless they are operating as a company or have a certificate of exemption issued by Inland Revenue. The normal tax rate ranges from 10.5% - 33%.
- Resident withholding tax on interest (10.5%, 17.5%, 30% or 33% on election) is not deducted when paying interest of \$5,000 or more per annum to a non-financial institution/individual (unless a certificate of exemption is supplied).

This tax is usually due on the 20th of the following month.

### Deductions

Deductible expenses may be claimed in the year in which they are incurred, even though payment may be made in the following year. Following are some special expenses which are either deductible in full or in part when they are incurred, but are related to the next income year.

The following expenses have no restrictions on the amount deductible:

- Stationery;
- Subscriptions to newspapers, journals, and other periodicals;
- Postage and courier costs;
- Rates;
- Road user charges; and
- Audit and accounting fees.

### Advertising

Prepaid amount less than 6 months and under \$14,000.

### Bad debts

To be deductible, bad debts **must** be written off **during** the income year. A mere provision or reserve is not deductible.

### Consumable aids

Amount on hand under \$58,000.

### Depreciation

- Taxpayers have the option of depreciating fixed assets on either a diminishing value or straight-line basis.
- Fixed assets can only be depreciated from the month of purchase, eg plant and machinery purchased on 25 March 2015 is depreciated for one month.
- Items costing up to \$500 (net of GST) may be written off in the year of purchase if certain criteria are met.

### Disability/loss of profits insurance

Premiums are deductible in full where the taxpayers are in business on their own account, or are employees.

### Discount reserve

A deduction for a discount reserve, such as a prompt payment discount reserve, is allowed if debtors are entitled to this discount.

In the first year, a deduction of 2.5% of the debtors' amount is allowed, and in subsequent years adjustments are made which maintain the discount level at 2.5% of the debtors' amount. If a higher discount is generally given, this could be used instead of the 2.5%.

### **Equipment service contracts or warranties**

The full amount is deductible, provided it forms part of the consideration for the assets.

### **Holiday pay**

The amount accrued at balance date is deductible, if paid within 63 days of the balance date.

### **Prepaid insurance premiums**

Where the total insurance expense under an insurance contract in the year does not exceed \$12,000, a 12-month prepayment is claimable.

### **Lease or bailment of livestock**

Prepaid amount less than 6 months and under \$26,000.

### **Other services**

Prepaid amount less than 6 months and under \$14,000.

### **Rent for land and buildings**

Prepaid amount less than 6 months and under \$26,000.

### **Repairs and maintenance**

Generally no deductions are allowed for a repairs and maintenance reserve, except for the periodic overhaul of business aircraft and the maintenance obligations of a construction firm under its building contracts.

### **Royalties**

Royalties accrued to balance date are fully deductible.

### **Service or maintenance contracts**

A prepayment of 3 months' expenses is deductible, provided the total expense on the contract does not exceed \$23,000 in the income year.

### **Subscriptions for trade professional associations**

A prepayment of 12 months is deductible provided the total amount for that association in the year does not exceed \$6,000.

### **Telephone and other communication equipment expenses**

A prepayment of 2 months is deductible.

### **Trading stock valuation**

Don't forget to do a stocktake!

New stock and work-in-progress valuation rules were introduced from the 1998-99 income year, and have applied since.

The valuation methods differ depending on whether or not you are a 'small taxpayer'. Small taxpayers are those who, together with their associates, have an annual turnover of \$3m or less.

If the turnover is less than \$1.3m and a reasonable estimate of the true value of stock is made to be under \$10,000 then a physical stockcount at year-end is not required and the opening stock value may be used.

Please contact us to establish the valuation rules that apply to your situation.

### **Travel and accommodation expenses**

Prepaid amount less than 6 months and under \$14,000.

### **Income**

Review credit notes in the months following balance date for any credits which are able to be taken back into the previous financial year.

### **Records required**

- Cash books/bank statements;
- Cheque butts, deposit butts;
- Documents relating to the purchase of fixed assets;
- Hire purchase/lease agreements;
- Solicitors' settlement statements;
- GST returns and workpapers;
- Wages reconciliation;
- Term loan statements;
- FBT return copies;
- Log books;
- Stock sheets;
- Debtors list; and
- Creditors list.

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