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## Remaining Robust in Times of Uncertainty

Global economic crisis, credit crunch, financial meltdown – all terms that have been echoing around the world in recent months. What has been happening around the world will inevitably affect New Zealand businesses. The state of the world economy is such that New Zealand cannot ignore what is happening – after all, given the relative size of the New Zealand economy, it is not able to influence the outcome of the current crisis.



From a New Zealand perspective, the question is whether businesses do nothing and hope for the best, or take appropriate measures to strengthen themselves for the storm to come and emerge on the other side in a relatively healthy state.

The majority of New Zealand businesses are small to medium sized enterprises (SMEs). Given the uncertainty for businesses at present, they need to make every attempt to safeguard themselves against the downturn in the economy. The mantra for businesses, to ensure survival in difficult times, must be “Cash is King!” Cash is the life blood of businesses.

What follows are some reminders for businesses of sensible and good business practice in uncertain times. They are by no means anything extraordinary that businesses must do; they are merely reinforcements of how to maintain a strong and healthy business.

### Cash Position

Businesses will need to take a more focussed approach to what their cash requirements are. What are the business cycles for the business? If cash resources are inadequate, it will need to talk to the bank to make appropriate arrangements. The business will need to review its overdraft facilities for adequacy.

For a large number of businesses in New Zealand, their stakeholders’ lifestyles are funded by the business. In the current economic climate, businesses should be prudent about how much funds are being extracted by stakeholders by way of drawings or otherwise.

### Stock

Businesses must determine the levels of stock required for operating the business at an optimal or efficient level. Too little stock means the business could be caught short; however, too much stock means cash is tied up unnecessarily. To get stock levels at as optimal a level as possible, the management should review turnover levels of the business, which will in turn provide information about when stock should be re-ordered. As part of the stock review process, any obsolete or slow moving stock should be cleared as soon as possible – they could become sale or discounted items. To move stock quickly, the business should also review its sales and distribution strategies.

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**Debtors**

The first thing to remember about debtors is that they represent money belonging to the business – money that is sitting in someone else's bank account. This is the time to ensure that the business has robust credit control policies. To encourage prompt or early payment, discounts could be given. Debtors, who may have been lax in the past with payment, may need reminders to prompt them for payment.

**Cost Management**

Businesses must also review their cost structure and, where possible, savings should be made. Wherever feasible, businesses should concentrate on their core functions and costs. Where

there is "dead wood" within the business, consideration should be given to pruning that part of the business. The business should identify which parts are operating efficiently, and which parts are not. Can efficiencies be improved upon? Where there are inefficiencies, management should isolate the reasons for the inefficiencies, and work on improving those parts of the business.

These are a few areas that businesses can focus on. There are many more areas and strategies that businesses can look at to ensure a robust future in difficult economic times. Businesses that have a strategy now are more likely to come out at the other end of economic unrest unscathed.

**Charities – The Ongoing Saga**

The deadline for registration of charities came and went on 1 July 2008. Dire warnings had previously been issued that any existing organisations with tax exempt status that were not registered by that date could be taxed on income received from that date to the date they became approved by the Charities Commission ("the Commission").

Inevitably, there have been applications received after 1 July 2008 from organisations that had tax exempt status. The Commission has the discretion, within the Charities Act 2005, to allow it to backdate the registration of those organisations to 1 July 2008. This was to allow for the time it would take the Commission to process all the applications received close to the 1 July 2008 deadline.

To help matters along, the Income Tax Act 2007 has been amended to accommodate late registrations. The effect of the amendment is that the IRD can use its discretion to allow the tax exempt status of the organisations to continue where they had been tax exempt before 1 July 2008 – provided they can show that they had taken "reasonable steps" to register by the deadline, and that they intended to complete the registration process.

The key to being able to take advantage of the IRD discretions is, of course, the ability to show that "reasonable steps" have been taken to start

and complete the process. What would constitute "reasonable steps"? Examples would be:

- A documented plan of action of steps being taken towards registration by 1 July 2008.
- Evidence of assistance being sought from professional advisers to advise on the registration process, and
- Trustee or Board minutes to show that formal decisions had been made to have the organisation registered by 1 July 2008.



If the organisation is able to show such reasonable steps were taken, the IRD should exercise its discretion to allow backdating of tax exempt status to 1 July 2008.

Another issue that may be currently overlooked is the difference between tax exempt status and donee status. Obtaining tax exempt status under the Charities Act does not automatically mean the organisation has donee status. Donee status is granted by the IRD. An organisation does not need to be a registered charity to obtain donee status. Organisations that had donee status before 1 July 2008 retain that status after that date, regardless of whether they have registered with the Commission as charities.

**Managing Staffing Levels in Tough Times**

For the last couple of years employers have been saying that the lack of good staff is the biggest constraint to the growth of their business. In stark contrast with this, over the last few months as the economy has tightened, employers have started laying off staff. It is never an easy thing to do, and it is really tough breaking up a good team. This article explores some of the alternatives to avoid

having to break up the team and some of the pitfalls that employers have walked into.

Firstly, if employers are having a tough time with sales, they shouldn't kid themselves that the staff do not know. The good ones take pride in their work and productivity and they know if they are busy with orders, or filling in time with otherwise

low priority tasks. They will be waiting and watching to see how the employer deals with the situation. The longer the employer tries to avoid dealing with it, the more nervous they will get. Even in tough times, the good ones will have other options and they will take them if they don't feel confident with the employer's handling of the situation. The good staff are also the ones the employer can least afford to lose.

If labour costs have to be reduced, several options can be applied. Start with controlling the



hours of work. Unless it is absolutely critical, stop all overtime and casual / temporary workers. Where staff on wages are working more than the minimum hours stated in the employment agreement, their hours should be reduced to the minimum. Where staff have accumulated annual leave, they should be encouraged to take it.

to take it.

The next step is to look at reducing the contracted hours of work. To do this the employer will need to have the agreement of the staff affected, otherwise it is a unilateral change to the employment agreement. If this option is being considered, the employer will need to reflect on what is fair for the individuals. A reduction of 4 hours a week is a 10% pay cut for a full time staff member but a 20% cut for a person who works 20 hours a week

## Associated Persons Update

Throughout the Income Tax Act, situations arise that require consideration of whether or not two persons are associated. The definition of 'associated persons' differs depending on what part of the legislation is being considered. In March 2007 the Government issued a discussion document seeking feedback on proposed changes to the associated persons rules. The document received considerable negative exposure and feedback because of its proposed changes to the definition of associated persons for land transactions. The Government received 867 submissions, with the majority focusing on the land related aspects of the changes.



Draft legislation introduced in July 2008 builds on the discussion document and looks to introduce some

of the proposals in the discussion document as law.

If this hasn't achieved the desired savings, the employer will have to look at reducing staff numbers. Identifying those who want to go and pursue other options is the least painful approach. Are there any staff who are considering retiring or resigning? Is anyone planning to do their 'overseas experience' and do they want to bring it forward?

Finally, there might come the decision to actively lay off individuals. It is really important that there is genuine consultation with the staff, explaining the situation and the options. How should this be done? Should a team be removed, should all part time jobs be stopped or should there be a selection of individuals? Whichever choice is made, it has to be justifiable in the eyes of the law. That includes both a fair process and a genuine need for change.

In one case, an employer developed a comprehensive method for assessing and rating the suitability of the employees they were considering making redundant. But instead of appointing those who got the best ratings, they selected the individuals they wanted and ignored the ratings. The redundancies were found to be unjustified dismissals.

Therefore, employers who find themselves having to cut staff costs should seek advice before embarking down a path that may turn out to be the incorrect one. It is cheaper to get good advice than to get it wrong.

The draft legislation proposes one general definition for associated persons, which will have universal application across the Income Tax Act, accompanied by a number of qualifications and exceptions for specific circumstances. Consolidating the definitions is aimed at simplifying the law and minimising the opportunity to circumvent the rules through complicated structures.

A number of the unwelcome proposals in the discussion document that related to land have been included in the draft legislation. The friction arises because the current associated persons rules allow a person in the business of dealing in or developing land, or erecting buildings on land, to hold investment property in another entity and not have that property 'tainted'. If a property is tainted it means that it is likely to be taxable on sale if it is sold within ten years of acquisition. The new proposals introduce associated persons definitions that can effectively render land, which is held as investment property, to be taxable on sale. Taxing land that is in substance held as investment property, such as a rental property, is in effect levying a capital gains tax.

In the context of association, for the purposes of land, key changes include:

- **Trusts** – under the current associated persons rules two trusts cannot be associated. Under the proposed rules, two trusts with the same settlor (or same protector) will be associated, and the settlor of a trust will also be associated with that trust.
- **‘Daisy-chaining’** – currently, in a situation with 3 parties, A and C may not be associated, even though A is associated with B, and B is associated with C. A limited tripartite test will now be introduced where two people will be associated (A and C), if they are both associated with a common third party (B), (i.e. daisy-chaining).
- **Aggregation** – when determining if two companies are associated, shares held by a shareholder in a company will also be deemed to be held by any other person that is associated to that shareholder.

A common current structure involves a development company's shares being held by a Trust (settled by ‘Mum or Dad’), and for a rental company's shares to be held by ‘Mum and Dad’. Under the existing rules the two companies are not associated as the same persons (the individuals versus the Trust) do not hold 50% or more of the shares in both companies. Under the proposed rules the individuals as settlors would be associated with the Trust, and therefore the shares held by the Trust would be deemed to also be held by the individuals, resulting in both companies being associated. Due to the association, land purchased by the rental company after the rules come into force is likely to be taxable on sale if it is sold within 10 years of acquisition.

If enacted, these changes will take effect from the 2009 – 2010 income year, although the provisions relating to land will only apply to land purchased, or improved (in the case of builders) from 1 April 2009. Existing holdings of land are therefore unaffected. In isolation, these changes may appear minor. However, their combined effect will have major implications for many taxpayers.

## Snippets

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### Family Tax Credit Increase

The annual amount of the minimum family tax credit, which guarantees a family's after-tax income, rises from \$18,460 to \$20,540 from 1 April 2009. This increase was approved by Order in Council on 6 October 2008.



### FBT Interest Rate for Low-interest Loans

The prescribed rate used to calculate fringe benefit tax on low-interest, employment-related loans rose from 10.57% to 10.90% from 1 October 2008.

### New Secondary Tax Rate

The Government announced on 7 October 2008 that Cabinet has agreed to a new, bottom secondary tax rate of 12.5%, from 1 April 2010. Hon. Peter Dunne said, “Secondary tax rates are not intended to tax income earned from two or more jobs more heavily than the same income derived from a single job.”

Lowering the secondary tax rate is not actually a tax cut. Taxpayers' tax obligations do not change - lowering the secondary tax rate merely reduces the chances that taxpayers will be overtaxed during the course of the year. Where taxpayers have been overtaxed, they will be entitled to a tax refund at the end of the year.

### Eft-Pos Machine

We are pleased to advise that we now have an Eft-Pos machine available for your convenience.

### Papers In

Just a reminder to those clients out there who have not brought their 2008 papers in to please do so as soon as they can. Don't forget to complete your checklist – this will help us complete your accounts efficiently.

### Christmas Closing Hours

As this will be our last newsletter before Christmas we would like to wish you and your family a safe and happy Christmas and a prosperous New Year.

Our office will be closed from midday on Tuesday 23 December and we will be re-opening on Monday 12 January 2009.

### Business Northland Article

We would like to draw to your attention the article written by Brent Martin, titled “**Doing Business in Tougher Times**” which was published in the November issue of Business Northland magazine.