

# de Lacey & Associates Limited

CHARTERED ACCOUNTANTS

## NEWSLETTER

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### New year's aspirations

For many, a new year signals the start of a fresh beginning allowing goals and motivation to be reset. We typically try to leave the downsides of the prior year in the past and reassess our aspirations for the year



to come. However, given the year that was 2020 and the ongoing impact of Covid-19, both locally and globally, there are various aspects of 2020 which have inevitably carried into 2021. Whilst some of these lingering effects prove to be challenging, they are not necessarily all negative.

2020 was undoubtedly a time of great uncertainty for NZ businesses. However, it was also a year in which there was a notable increase in the number of new businesses registering with the Companies Office. Data shows that at the end of December, there were 669,000 companies on record, with 58,000 registered during the year; up from 49,000 during the prior year. It is thought that the increase can in part be put down to Covid-19 related redundancies and the transformation of "side hustles" into viable businesses - something that Christchurch led project, Start Me Up is backing.

Launched earlier this year, Start Me Up is looking for business ideas from Christchurch, Ashburton and Selwyn residents whose employment was adversely impacted by Covid-19. Run in conjunction with ChristchurchNZ and the Ministry of Social Development (MSD), the two-part programme aims to teach budding entrepreneurs how to start their own business. The first part of the programme is a five-week online course designed to teach the fundamentals of building a successful business. The second part of the programme offers 25 successful applicants the chance to further develop their business idea through in-person workshops with mentors. To be eligible to apply, applicants must

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currently be unemployed and receiving a benefit from MSD.

The Government also recently announced the launch of its Small Business Digital Boost programme, which seeks to support small NZ business owners to realise the potential of digitising their business. The partnership between the Ministry of Business, Innovation and Employment (MBIE), The Mind Lab and Indigo will provide government-funded digital skills training and support. In the age of the internet (and Covid-19), the ability to successfully utilise digital tools offers small businesses the opportunity to better compete in

today's economic environment. The programme is the first of several that will be rolled out as part of the Government's vision for New Zealand to become a "thriving digital nation".

A shake up in the job market also looks likely with new findings revealed by Horizon Research indicating that nearly 385,000 adults will look to change their job in the coming year.

Although it is not clear if or how many of these will look to pursue their own business ideas, the support for entrepreneurs looks stronger than ever. If there was a time for a New Year's resolution and change, maybe this is it.

## New trust annual return requirements

In December 2020 the legislation enacting the new 39% tax rate was passed. Within the same bill, somewhat overshadowed by the rate change, was the introduction of a new "annual return" requirement for trusts.

Not to be confused with the new Trustee Act that came into effect at the end of last month which requires certain disclosures to be made to beneficiaries, the annual return requirement included in the December 2020 bill imposes the disclosure of various trust information to Inland Revenue on an annual basis.

As enacted, the annual return for trusts will comprise:

- an income statement and balance sheet;
- details of any settlements made on the trust during the year;
- the name, date of birth, country of tax residence and IRD number of any person who makes a settlement on the trust in the year, whose details have not previously been provided;
- details on every distribution made by the trust during the year, including capital distributions, as well as details on the recipient beneficiaries; and
- details of any person who has the power to appoint and remove trustees and beneficiaries of a trust.

The requirement will not apply to non-active, charitable or Maori authority trusts and foreign trusts that are already filing disclosures with Inland Revenue.

Although the legislation applies for the 2022 income year onward, there is a provision which allows



Inland Revenue to request the same annual return information for any period between the 2015 and 2021 income years.

Inland Revenue is likely to use the information to monitor the extent to which income is being taxed to trusts at 33%, that would have been taxed at 39% if derived by individuals. That information could then be used as a

basis for the Government to either increase the trust tax rate or increase the extent that beneficiary distributions are taxed to individuals.

The information could also be used by Inland Revenue to specifically check other areas of compliance. For example:

- Imputation streaming rules require dividends received by a trust that are then distributed to a trust's beneficiaries to be spread proportionately across those beneficiaries, otherwise imputation credits may be forfeited.
- Taxable income can be triggered if a trust receives the benefit of a debt forgiveness and a subsequent distribution is made to a corporate beneficiary.
- Application of the land taxing rules can depend on whether parties are associated. The level of disclosure will enable Inland Revenue to readily determine who a trust is associated to.

As time passes and the amount of information held by Inland Revenue increases, they could proactively identify errors in a trust's tax position. Especially if a trust has moved from one accountant to another and Inland Revenue has a clearer picture of past transactions than the new accountant has.

## The 39% rate change

The top personal marginal tax rate increases to 39% on income over \$180,000, with effect from 1 April 2021. Businesses should consider what the flow-on effects are and forward plan to ensure they are not

caught off guard. Two key areas are discussed in this article.

Simplistically put, a company pays income tax at 28%. Imputation credits arise from that tax paid and

are used to reduce the tax payable by shareholders when dividends are paid. Further tax may be payable by the shareholder if the tax liability on the dividends is more than the imputation credits.

If shares in a company are ultimately held by an individual, consideration should be given to declaring a dividend prior to 1 April 2021, in which case it will be taxed to the individual at 33% (rather than 39% to the extent income would exceed \$180,000 from 1 April 2021). This requires a comparison between the income tax liability that will be triggered upon declaring a dividend prior to 1 April 2021, versus the expected future income tax liability that will be triggered if a dividend is declared on or after 1 April 2021.

The FBT regime ensures tax is paid on non-cash benefits provided to employees, such as company vehicles and fuel cards. When calculating FBT, employers have the option of using one of the following methods:

1. The single rate option, where a single rate of 49.25% is applied to all benefits provided to employees.
2. The short-form alternate option, where rates of 49.25% and 42.86% are applied to attributed and non-attributed benefits, respectively. This appeals to employers who predominantly provide attributed benefits to employees who earn more than \$70k.
3. The full alternate rate option, where a separate calculation is undertaken for each employee who has received attributed benefits with



reference to each employee's salary. A rate of 42.86% is applied to non-attributed benefits. This appeals to employers who predominantly provide benefits to employees who earn less than \$70k.

Typically, benefits that are subject to FBT are provided to higher-earners, and consequently, the 49.25% FBT rate under the default FBT method equates to the current top marginal personal tax rate of 33%, which keeps the FBT filing process simple.

The full alternate rate option takes considerably more time to calculate, and as a result, employers that value time and efficiency tend to use the single rate or short-form alternate rate option, irrespective of the cash savings that the full alternate rate can provide.

With the introduction of the 39% marginal tax rate, the 49.25% and 42.86% FBT rates will be increasing to 63.93% and 49.25% respectively from 1 April 2021. This effectively means employers that use the single-rate option will be paying FBT as if all employees earn more than \$180,000, when in reality the 39% rate is expected to apply to only 2% of New Zealanders. As a result, employers may wish to consider undertaking the short-form or full alternate rate calculation from 1 April 2021, as the cash saving may exceed the additional time and effort.

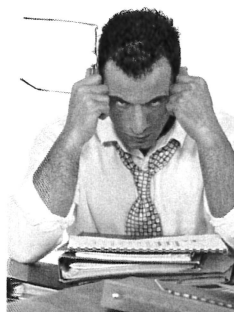
In the lead up to the 2022 financial year, companies should be exploring different options to ensure tax efficiencies are achieved.

## Directors' duties

Company directors have a duty under the Companies Act 1993 to not trade recklessly or take on obligations that their business cannot perform. Balancing the continued survival of a company versus their obligation against reckless trading has been a key feature of the Covid-19 economic environment.

Recognising that the economic impact of Covid-19 placed some companies in temporary financial distress as they adjusted to their new trading environment, amendments were made to the Companies Act 1993 for the benefit of directors. The amendments provided safeguards for company directors enabling them to take a longer term view of a company's ability to trade. However, those safeguards ceased from 30 September 2020, so directors need to revert to the more stringent approach required prior to the amendment.

In a timely reminder of directors' duties, the recent Supreme Court decision *Madsen-Ries v Cooper*



[2020] illustrates when the actions of directors will be in breach of their duties.

Mr Cooper was the sole director of Debut Homes Ltd (Debut) a residential property developer. In 2012 Debut owed Inland Revenue more than \$300k of GST, amongst other creditors. Mr Cooper was advised by his accountant that these debts were insurmountable. However, with 6 properties under development, Mr Cooper persisted in expectation of the profit from their sale. Additional finance from third parties, guaranteed personally by Mr Cooper, and a loan from his family trust, were used to complete the properties and pay secured creditors. However, no GST was paid to Inland Revenue on the sale of the 6 properties, adding to the GST liability already outstanding.

Finally, in March 2014, Debut was placed in liquidation by Inland Revenue with a GST liability exceeding 500k (including interest and penalties). The High Court held that Mr Cooper breached his

duties under the Act by continuing to trade in a manner that benefited some creditors but was detrimental to others.

In September 2020 the Supreme Court restored the High Court's orders and allowed the appeal by the liquidators. The actions of Mr Cooper amounted to reckless trading and a breach of a director's duty to not enter obligations on behalf of the company where there was no intention or ability for the company to meet those obligations. Mr Cooper will

likely be personally liable for some or all debts of the company and potentially barred from being a director.

Perseverance has been key to survival for many businesses during COVID-19. However, continuing to trade with the belief that a business will be profitable, while ignoring the reality of the balance sheet risks directors breaching their professional duties.

## Snippets

### COVID support packages



While we have enjoyed relative freedom in New Zealand, the Government has continued to work on Covid-19 support packages.

The COVID-19 Leave Support Scheme allows those who have been told to self-isolate, to receive two weeks income if they are unable to work from home. In addition to this scheme, from mid-February 2021 a Short-Term Absence Payment will be available for those who need to stay at home while awaiting a COVID-19 test result.

The Business Finance Guarantee scheme can be applied for until 30 June 2021 and allows small and medium sized businesses access to up to \$5 million to support operating cashflow and asset purchases, as well as helping respond or recover from COVID-19. This scheme is supported by the Government so if the business defaults on the debt the lender can claim 80% of the defaulted debt from the Government.

Applications remain open until the end of 2023 for the Small Business Cashflow Loan Scheme, which allows organisations that employ 50 or fewer employees that have been adversely affected by COVID-19, access to a one-off 5-year loan. Organisations can draw down up to \$10,000, plus an additional \$1,800 per employee. No repayments are required for the first two years, however, following this the interest rate increases from 0% to 3%.

Until April 2022, the Apprenticeship Boost Initiative will be available to support employers of first and second year apprentices. The amount of funding received a month depends on when an apprentice started their training. Employers can use the funding to top up apprentices' wages to at least the minimum wage.

The various wage subsidy schemes can no longer be applied for. These are only put in place if the Alert Level increases to Level 3 or 4 for 7 days or more, so hopefully we don't see these again.

### Pink collar crimes

We have likely all heard about white collar crimes, where financially motivated nonviolent crimes such as embezzlement are committed by high profile business people. However, pink collar crimes, referring to typically female office workers in low-to mid-level positions who steal money from their employers, have been on the increase.



One of the largest instances was in Singapore where an accounts clerk embezzled more than \$46 million over 7 years by depositing business cheques into a personal account used to fuel a gambling habit.

In New Zealand a McDonalds Manager stole \$166,000 as she was able to authorise cash refunds to customers. It wasn't until an internal audit disclosed the disproportionately high amount of refunds paid out when the particular manager was on duty, that she was apprehended. Further examples include an accounts clerk paying herself just under \$90,000 in wages in a 12-week period and a casino worker stealing \$45,000 in gambling tokens in the space of one month.

Does this mean that the innocent accounts clerk, bookkeeper or manager may not be as innocent as we all think? Well potentially. Companies continue to invest large amounts of money into anti-fraud systems and in some cases even have teams in place to detect such occurrences. So how does this go unnoticed? A couple of hundred dollars here and there can be harder to spot, but eventually adds up.

Along with high-tech software detection systems, don't forget to just look out the window and ask yourself, how does your employee afford the insurance on her Ferrari?

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