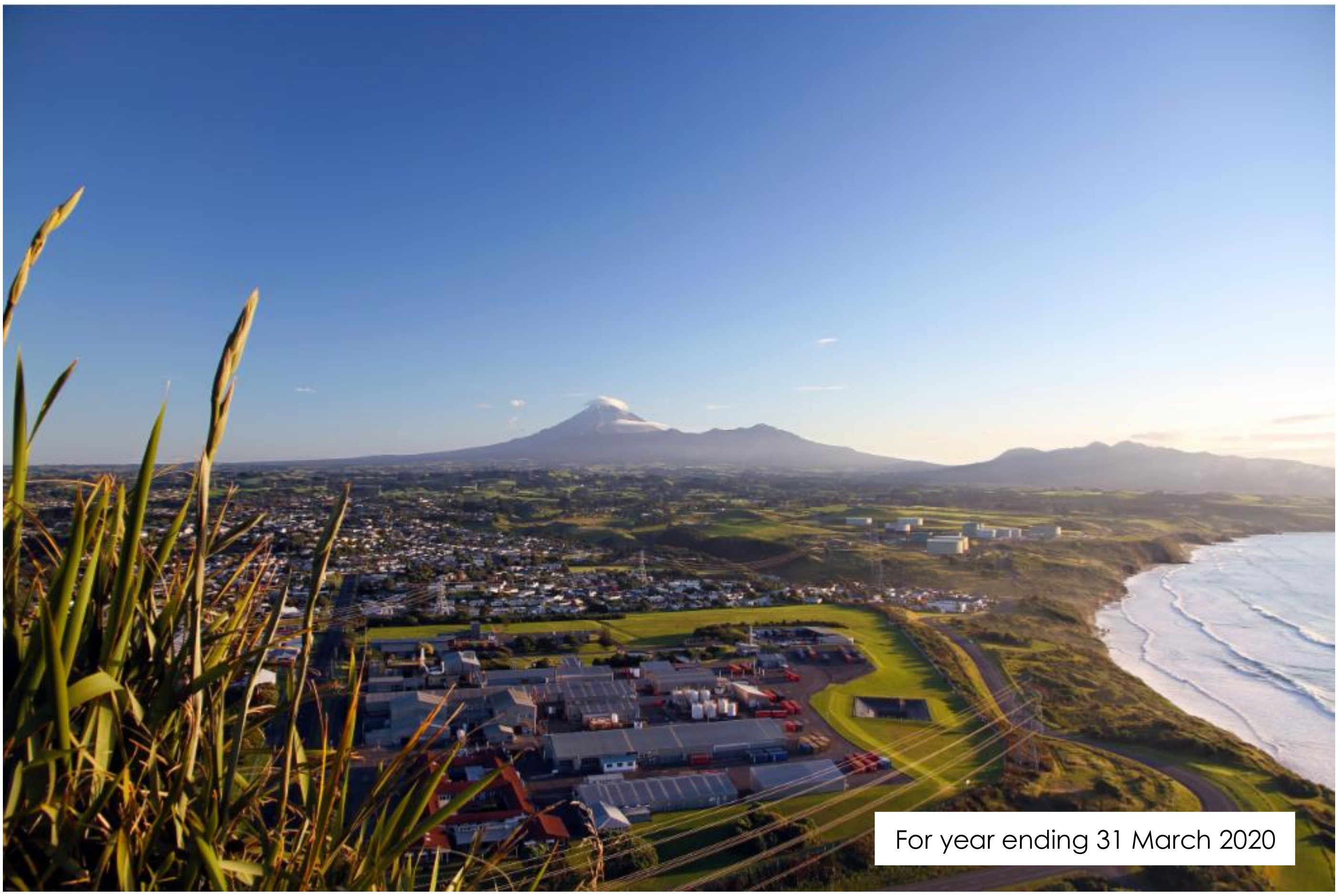
Guide to year-end tax planning



For year ending 31 March 2020

Year-end tax planning checklist

The end of the 2020 financial year is now approaching. This is an appropriate time to consider your year-end tax position and 2021 provisional tax.

Below is a checklist of matters relevant to all business entities which you should consider before your year-end balance date, some of which may help you reduce the amount of tax you have to pay for 2020.

1. Fixed asset / intangibles considerations

For many businesses, fixed assets and intangibles comprise a large part of their asset base and give rise to material tax adjustments. We recommend fixed asset registers are reviewed regularly and the following points considered:

Fixed asset register review

You should review your fixed asset register to ensure assets are classified correctly and the correct tax depreciation rates are being applied. Assets can be written off the fixed asset register if they are no longer used in the business and the cost of disposing of the asset is greater than its disposal value.

Repairs and maintenance

At year end, repairs and maintenance expense accounts should be reviewed to consider whether they contain any capital expenditure. Amounts should be capitalised for tax if the expenditure is greater than $500 and relates to:

- the purchase of an asset or
- improving or replacing a significant part of an asset.

Generally, no deductions are allowed for a repairs and maintenance reserve. It may be worthwhile undertaking repairs and maintenance prior to balance date to obtain a full deduction.

New property measures

The new bright-line test ensures that anyone buying and selling residential property within five years will pay tax on the profits (with limited exceptions, including the main home exemption). Have you bought and sold any residential land or property between 29 March 2019 and your year-end?

If you have obtained an IRD number for a trust, as part of the new administrative requirements for purchasing a property, you may wish to apply for a non-active trust filing exception (this will remove the requirement to file annual income tax returns).

Feasibility expenditure / R&D

- The costs of unsuccessful software development are deductible in the year the project is abandoned.
- R&D and black hole expenditure rules introduced in 2016 allow:
  - start up R&D intensive businesses to cash out tax losses in certain situations
  - a one-off tax deduction for capitalised development expenditure, where the intangible asset is written off for accounting purposes
  - the cost base of certain intangible assets (with a useful life that can be reasonably estimated) to be expanded.

2. Bad debts

To claim a deduction for a bad debt in the current year, the debt must be bad, and must be written off during the year. Further, there must be evidence to verify that the debt has been written off.

Recent changes to legislation now allow a deduction for a bad debt when the debt has been remitted by law or a debt company has entered into composition with creditors in relation to the debt.

GST on bad debts written off can be claimed back as an input tax deduction. Include the GST component of any bad debts written off in the credit adjustments box of your GST return (Box 13).

3. Retentions

Retentions on building contracts are generally taxable in the year the contractor becomes legally entitled to receive them. Therefore, if retentions are outstanding at year end, they usually do not form part of your income for tax purposes for that year and are therefore only taxed when they become due. This can result in a significant deferral of income.

4. *Valuation of trading stock (not including livestock)*

Trading stock must be valued using one of the following valuation methods:

- cost
- replacement price
- discounted selling price
- market selling value

Stock obsolescence expense is not deductible for tax purposes. Therefore, to reduce the value of obsolete stock on hand, it should be physically disposed of or, alternatively, valued at market selling value.

The market selling value may be used only when it is lower than cost and can be substantiated ie by providing evidence of sales records from before and after balance date. It must be calculated on an item by item basis (broad formula write downs are not allowed).

Replacement price and discounted selling price may be used to approximate cost if these methods are also used for financial reporting purposes.

5. *General accruals*

For accruals or provisions of expenditure to be deductible in the current year, the expenditure must be definitively committed to and capable of reasonable estimation before year end.

Expenditure that is merely contingent, pending or threatened will generally not meet the incurred test. Accruals which are akin to general provisions will generally not be deductible.

Holiday pay and bonuses for employees

Employee provisions such as accrued annual leave, bonuses, long service leave or commissions are only deductible in the current year if they are paid out within 63 days of balance date.

Even if expenditure meets the "incurred" test, it will be still be non-deductible to the extent it relates to:

- goods which have not been used by year end or
- services which have not been performed by year end or
- choses in action which remain enforceable

There are exceptions to this rule, and certain incurred prepaid expenditure may be claimed as a deduction in your 2020 tax return, provided it has not been capitalised to the balance sheet as a prepayment.

Some prepaid expenses are deductible regardless of the amount or period being prepaid, for example:

- stationery
- subscriptions for papers or journals
- vehicle registration and road user charges
- postal and courier charges
- rates
- audit and accounting fees

Other prepaid expenses will only be deductible if they were paid in advance up to a certain limit.

6. *Lease inducement/surrender payments (commercial leases)*

These payments are now on revenue account for both the payer and payee:

- Lease inducement payments are now deductible to the landlord and taxable to the tenant, spread over the term of the lease.
- Amounts paid in consideration for the surrender or termination of a lease are taxable to the payee and deductible to the payer in the year they are derived or incurred.

7. *Mixed use assets*

There have been changes to the income tax and GST rules for assets used for both business and private purposes. These are primarily targeted at baches, boats, planes, and helicopters (used privately and to derive income) and potentially to other assets used both for business and private purposes.

Consideration should be given to these rules if you have any assets that you use both privately and to generate income.

8. *Legal fees*

- $10,000 de minimis concession.
- Fees need to be connected with business activity ie nexus test met.
- Overrides capital limitation – legal fees deductible irrespective of whether legal fees are capital in nature.

Note: all legal fees (including those not connected with the business) are included when calculating threshold.

9. *Prepaid Expenditure*

Certain types of expenditure can be claimed as a tax deduction in the year in which they are incurred regardless of the fact that the good or service will not be used until a future year

- Advertising for up to 6 months after the balance date and not exceeding $14,000 in total;
- Insurance for up to 12 months after the balance date as long as the premiums incurred during the year for the contract do not exceed $12,000;
- Rates to the extent of the amount invoiced on or before balance date;
- Rent for up to 6 months after the balance date and not exceeding $26,000 in total. There is no monetary limit for rent that is prepaid not more than one month in advance;
- Subscriptions or fees for membership in any trade or professional association, for up to 12 months after the balance date as long as the expenditure incurred during the year for membership in the association does not exceed $6,000;
- Advance bookings for travel and accommodation, to be used within 6 months after balance date and not exceeding $14,000 in total;
- Service or maintenance contract for plant, equipment or machinery, for up to 3 months after balance date, as long as the expenditure incurred during the year for the contract does not exceed $23,000;
- Use or maintenance of telephone and other communication equipment for up to 2 months after balance date (amount is unlimited);
- Consumable aids (i.e. items that do not become a component of the finished stock, e.g. oil, grinding wheels, chemicals, wrapping and packaging) not exceeding $58,000 in total;
- Audit fees and mandatory accounting fees (unlimited);
- Stationery, subscriptions for newspapers, journals or other periodicals, and postal and courier services (unlimited).
- Vehicle registration fees, drivers license fees and road user charges (unlimited);
- Other services for up to 6 months after balance date, and not exceeding $14,000 in total;
- Other periodic charges for up to 12 months after the balance date, and not exceeding $14,000 in total

Record keeping

To prove your deductions are legitimate you must keep all relevant records for at least seven years and they must be in English (unless the Commissioner has approved otherwise).

The following records must be kept:

- all income received (copies of invoices issued, etc)
- all tax invoices and receipts for purchases, insurance, power, phone and all other costs incurred
- credit and debit notes
- bank statements
- cash books or computerised accounting records
- wage records for any employees
- interest and dividend payments
- a list of business assets and liabilities
- depreciation schedules
- statements of year end trading stock and stock-take records
- motor vehicle log books
- details of entertainment expenses for clients, staff or suppliers
- final profit and loss statements and balances sheets.

Please note this is not an exhaustive list.

Keeping records in order makes good sense. If you are investigated by Inland Revenue, you should be able to justify all your claims with a minimum of time and effort.

If you need help with any of these issues, please contact our office on 06 757 5477.