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Newsletter

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Introduction

Important: The final provisional tax payment for 2006 is due on Tuesday 7 March.

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Provisional Tax Due

The third and final instalment of 2006 provisional tax is due on Tuesday 7 March 2006.

The amount you need to pay is contained on your Payment Schedule in the letter accompanying your completed tax return.

If you think that your income has increased significantly over the last year you may wish to make a higher payment so that you don't have too much of a top up to make after 31 March.

Similarly if you have earned more than $120,000 you will need to estimate your income for the year and pay the provisional tax based on that income.

Remember that penalties are imposed if your estimate is more that 20% less than the actual amount, and interest is charged on any underpayment.

Terminal Tax Due

Your final wash-up payment for 2005 income tax is due on 7 April 2006. Again this would have been included on your Payment Schedule but if you have any queries please call me as soon as possible as I'll be away from 1-12 March.

Late payment penalties are charged if even one day late so its worthwhile paying on time.

Depreciation on Inherited Assets

There has been much confusion over the past few years about whether inherited assets could be depreciated. The argument went along the lines that because the asset hadn't cost the recipient any money then there was no cost to depreciate. This commonly affected rental properties and business assets, particularly farming.

From 1 October 2005 legislation was enacted to clarify the situation. From that date a disposal is deemed to have occurred both at transmission (when the assets pass to the estate executor) and again on distribution to the beneficiaries. The result is that the deceased taxpayer has to include any depreciation recovery on the difference between a higher market value and the book value of any business assets at the time of death. Similarly if the market value is less than the book value then there is a loss to offset against taxable income.

When the assets are then transferred to the beneficiaries the same process is repeated and any further increase in market value over book value is treated as taxable income to the estate (and any decrease as a loss). Obviously if there is only a short period between transmission and the final distribution then the market value is unlikely to have moved significantly.

However if the estate assets cannot be distributed, for example, if a remaining spouse has a lifetime interest in property then, not only may there be no assets to sell to pay the deceased's tax but significant tax liabilities may accumulate for the estate.

There are two main ways to mitigate these complications. First, if the asset base is not significant, perhaps a family home and some investments, then it may be sufficient to own the assets jointly. Upon death the assets are passed automatically to the surviving spouse.

However if significant assets are involved, for example ownership of a family business then it may be worthwhile considering putting all personal or family assets (including shares in family or other companies) into a family trust.

Using company and trust structures means that the death of a key person will have little impact

on the ownership of assets as there is no need to transfer ownership and no depreciation recovery is required.

Don't forget though that plans need to be in place for the loss of key personnel.

Budget update

You may remember that in last year's budget on May 19 it was announced that new depreciation rates would be brought in from 1 April 2005. The main one affecting businesses was moving the depreciation rate for computers from 48% on the diminishing value basis to 60%.

The main one for property investors was that any buildings bought after 19 May 2005 could only be depreciated at a top rate of 3% on the diminishing value basis.

The other significant item was that assets costing less than $500 (excluding GST) could be expensed. Previously assets costing more than $200 had to be depreciated.

However legislation bringing these changes into effect has not yet been passed although it is still expected that this will happen before the end of the financial year (31 March) so that all 2005/6 tax returns can be correctly completed.

FBT on vehicles

Another significant change, coming into effect from 1 April 2006, will allow FBT to be calculated on the depreciated or book value of a vehicle. Taxpayers will be able to choose whether to continue paying FBT based on the cost price (as at present) or to move to the book value.

If you continue to use the cost price option then the rate to calculate the fringe benefit will reduce from 24% to 20% of the GST exclusive cost of the asset and the rate to use for the book value option is 36%.

Moving to book value will remove the anomaly whereby the FBT payable did not change over the years yet the value of the vehicle reduced significantly.

It will also reduce the use of some leases such as 9-5 leases and 1 by 1 by 1 leases which were always difficult to structure to IRD's satisfaction.

If you are currently paying fringe benefit tax on vehicle use then it may be worthwhile doing some calculations to see if using the book value option (with the higher rate) will be an advantage to you.

Again this legislation has not yet been passed but the delay is understood to be procedural rather than because there is any concern or opposition to it. It is expected to be passed for the 2006/7 tax year.

Taxing overseas investments

Those of you with overseas investments will be pleased that there has been a reduction in plans to tax all capital gains on overseas shares, whether realised or not. This regime is in effect a capital gains tax on unrealised overseas share investment and encourages people to bring their money back to NZ and probably invest in property which is the last thing the Reserve Bank wants!

The recent back down has seen Australian shares being exempted meaning that as long as the shares were bought with the intention of deriving taxable income (with any capital gain only incidental) then any increase in value when sold will not be taxed in NZ.

Also if your portfolio of overseas shares is worth less than $50,000 then you are exempt from the regime.

If no other changes are made there may be a case for moving share investments to Australia or considering spreading investment ownership across family members to keep beneath the $50,000 threshhold.

Checklists

As it is near the end of the 2005/6 tax year I have attached checklists to help you prepare for your tax return.

Contact details:

Please remember that the information in this newsletter is of a general nature only. For advice relevant to your situation please contact me.

I'll be overseas from 1-12 March.

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