Newsletter 3 June 2002

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Intro

Welcome to my third newsletter! It's provisional tax payment time on 7 July so I've included an explanation of provisional tax payment options.

If you believe you have something to pay, don't know what the amount is, and haven't had an email from me, then please phone me on 971-1500.

Again, please let me know if there are topics you would like explained via this newsletter.

Topics:

- Provisional tax
- Depreciation on your home office
- Contact details
- Holidays

Provisional tax

The first instalment of 2002/3 provisional tax is due 7 July 2002, ie this Sunday.

To work out what, if anything, you need to pay, follow these steps:

Did you pay > $2,500 in tax on your business earnings for the year ended 31 March 2001 (excluding any provisional tax payments)?

If no, have you sent in your IR3 tax return to IRD for the year ended 31 March 2002?

If no, then you do not have to pay any provisional tax on 7 July, 2002.

If yes to either of the above questions, then you need to make a payment by 7 July.

If you have already sent in your return for 2002 then the amount you have to pay is set out in the payment schedule letter I have sent you when your return was completed. This will be • of 105% of your terminal tax for the 2002 year.

If your tax return for the year ended 31 March 2002 has **not** been sent to IRD then you can calculate your provisional tax to pay at • of 110% of your terminal tax (ie your total tax) for the year ended 31 March 2001.

Tax $30,000 or less

If you follow the above (this is the standard method) and your tax for 2003 is $30,000 or less (income (after business expenses) of around $100,000) then you will not be liable for penalties or Use of Money Interest (UOMI) ($30,000 tax or under is the "Safe Harbour Threshhold").

Tax > $30,000

If your tax is > $30,000 then you can follow the standard method as outlined above, but IRD will calculate your tax at the end of the year and will charge you UOMI on any provisional tax payment which is less than • of your final or terminal tax.

Estimate

You may decide that your income will be significantly less than in the previous year and that you should pay less provisional tax each period than previously. (Beware though, a number of clients have expected to have a quiet year, estimated their provisional tax payments at a low level, and ended up with significant work contracts, resulting in even higher tax than expected and they have been charged UOMI.)

Anyone can estimate their tax for the year and pay • at each provisional tax instalment (7 July, 7 November and 7 March).

However if you have made an estimate (even if your tax is under the $30,000 Safe Harbour Threshhold for the year) then you will be charged UOMI on any underpayment and you may be charged penalties for significant underestimates.

Remember though that you can change your estimate at any time.

Use of Money Interest (UOMI)

UOMI is currently charged at 11.93% for underpayments and IRD will pay you 4.83% for overpayments.

Queries

If you have any queries about provisional tax that aren't explained here, please phone me.

Depreciation on your home office

If you are running a home office, which you almost all will be, you are entitled to claim a portion of the depreciation on your house. This portion is based on the % of your house which your business uses.

Calculation Example

Depreciation is calculated on the building only. It is calculated as follows:

a x b x c

where:

a= the building portion of your property valuation at the beginning of the use of the house as a home office. You can often obtain this from the annual Quotable Value RV notice or a rates notice. It is the capital value, minus the land value. On some notices the building will be identified as "the value of improvements".

b= the depreciation rate. This is generally 4% on a diminishing value basis (ie take off the total amount depreciated last year) or 3% straight line (ie the same amount each year).

c= home office percentage of the property used.

For example,

a: valuation of property per QV = $300,000. The value of the land was $100,000 and therefore the value of the building improvements is $200,000.

b: rate used: 4% DV (to maximise the deduction) so

$200,000 x 4% = $8,000.

c: office % used: 12%, so

12% of $8,000 = $960.

Therefore $960 can be claimed as a tax deductible expense. This is a tax benefit of around $300 (33% of $960) but the more expensive your house, the higher the deduction.

In the second year "a" will be $192,000 ie $200,000 - $8,000 (not less $960!).

Therefore the calculation will be:

Depreciation: $192,000 x 4% = $7,680

Home office portion: $7,680 x 12% = $921.60.

Effect of sale

The catch is that when the building is sold or you change its use (eg you buy a new house, you rent out your house while overseas or you move into offices downtown (although this doesn't mean you need to stop claiming your home office for tax purposes!)), you will need to pay back any benefit received.

This only occurs with property because it tends to **appreciate** rather than depreciate.

So, for example, after 3 years of using the office in the above example you will have claimed the following depreciation:

Year 1: $960.00
Year 2: $921.60
Year 3: $884.73

Total : $2,766.33.

If you sell the house or otherwise have a change of use for the home office then you will need to show as income (called depreciation recovery) in Year 4: $2,766.33. You will then need to pay tax on this, around $900 (which is equivalent to the tax benefit you have received over the preceding 3 years).

As you can imagine with even small amounts of inflation, and the fact that you are always basing your depreciation deduction on the building value at Year 1, you are then financially better off by claiming the deduction now even if you have to pay it back later ie a $300 tax benefit now is worth more than in 4 years time.

Depreciation claim in year of sale

A small point to note: you cannot claim depreciation in the year of sale or change of use.

Recommendation

While I generally recommend taking the depreciation deduction on the building part of your home office, if you don't like "surprises" if you suddenly decide to upgrade your house or if you don't want the small additional paperwork, then you don't need to make the claim.

Holidays:

I will be away on holiday from approximately Thursday 11 July until Friday 19 July. For those of you also on holiday, have a happy and safe time!

Contact details:

If you have any queries about any of the above please phone me.

Phone: 971 1500
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