

Newsletter

No. 6 June 2003

Introduction

Important: Provisional tax is due on Monday 7 July.

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Provisional Tax

The first instalment of 2004 provisional tax is due on Monday 7 July 2003.

IRD no longer sends out reminders so make sure you make your payment on time. Otherwise penalties and interest will be incurred.

How much provisional tax will you have to pay?

If you have sent in your 2003 tax return then I will have sent you a schedule setting out your provisional tax payments for 2003/4.

If you haven't sent in your 2003 tax return to IRD then you can calculate your provisional tax for 7 July at 1/3 of 110% of your 2002 tax.

So, for example if your total tax for 2002 was \$14,000 then provisional tax for 2003/4 would be \$15,400 (ie 110% of \$14,000) and the payment on 7 July would be \$5,133.33 (1/3 of \$15,400).

More details are included in Newsletter 3 June 2002. This is on my website www.baubremurray.co.nz.

Call me if you're still not sure what you have to pay. Remember estimating when you don't have to (ie when your tax for the year is less than \$30,000) can lead to penalties and interest if you don't get your estimate exactly right!

How to make a Holiday Home Affordable

The easiest way to make a holiday home affordable is to set up an LAQC company to buy the property and make sure it is available for rent when you are not using it. More details about LAQCs are in my last newsletter (you can get any of my newsletters off my website). Remember that location is paramount!

By buying it in an LAQC you are ensuring that you can offset any rental losses against your own personal income (and reduce your own tax). You then need to make sure that it is available for rent when you are not using it – it doesn't need to be rented out but you need to be seen to be trying to rent it out eg have it listed with agencies, included in Baches listings etc.

For example if you buy a bach at Riversdale Beach for \$200,000 in the name of an LAQC you can claim expenses of \$13,000 a year in interest (\$200k at 6.5%), and around \$2,000 in rates and insurance. If you don't have any maintenance costs for the year (just to simplify the calculations but remember maintenance is tax-deductible) then your expenses for the year would be around \$15,000. If it is available for rent 40 out of the 52 weeks of the year then you can claim \$11,538 in direct expenses (ie 40/52 x \$15k) and another \$10,769 in building and chattel depreciation (average 10% of \$140,000 building value for 40 weeks).

If you get 8 weeks rent for the year (even though it is available for rent 40 weeks of the year) then you may receive around \$3,200 (8 weeks at \$400 per week - mostly off-season) in rent. This means your taxable loss is \$19,107 (ie \$3,200 - \$11,538 - \$10,769). This will give you a tax saving (at 33%) of \$6,305 so the real cost of your bach for the year was **\$5,495** ie \$15,000 expenses less rental income \$3,200 less tax saving of \$6,305. This is a weekly holiday cost of \$458 per week for 12 weeks plus hopefully you will be accumulating an incidental but welcome capital gain.

Hope you didn't get lost in the figures – it may be worth while going back over them and plugging in your own figures!

Structures

In the last Newsletter I discussed Qualifying Companies (QCs) and Loss Attributing Qualifying Companies (LAQCs). This time we look at the advantages and disadvantages of Companies (whether a QC, LAQC or ordinary company) over the sole trader structure.

Advantages of Companies:

- § Opportunities to separate different trading activities
- § Opportunities to limit liability
- § Opportunities to spread income over years for lumpy income (which leads to tax savings)
- § Greater opportunities for income splitting (especially where there is one main income for a family, by making the non-working parent a shareholder)
- § Easy to sell either in full or part by selling the shares

Disadvantages of Companies:

- § Some extra administration cost ie extra tax return and annual return to the Companies Office, need separate bank account etc
- § Need some set-up time – as opposed to sole traders who can just start operating.

Tips for Great Financial Management

- § Pay your credit card off every month ie the full amount by the due date.
- § If you are disciplined about paying it off each month (full amount by due date) then use it to buy everything. That way you get the benefit of paying less interest if you have a flexiloan and you normally pay your bills out of the flexiloan account. Plus you get the benefits of credit card rewards eg cashback, hotpoints, airpoints etc.
- § Take out a flexiloan by all means but don't take it out by more than you can pay off in a good month or two. For example if you have a \$200k mortgage then don't take out \$100k fixed at 6.5% and \$100k on flexiloan at 7.5% if you are only going to be able to put up to \$10k into the account for the month.

If you take out \$190k at 6.5% and \$10k at 7.5% you will save \$1,000 a year.

If your flexiloan is at 8% and your fixed rate at 6% then by having only \$10k on flexiloan you will save \$2,000 a year in interest. Do the calculations for your own situation.

- § Remember it is better to increase your flexiloan than be paying high interest rates on unpaid credit card bills or paying your tax under a payment arrangement with IRD. But don't be caught out like the couple who bought their home for \$200k 10 years ago with a mortgage of \$160k. Their home is now worth \$350k and their mortgage \$280k. While their equity has increased \$30k (and they have had lots of neat holidays and new cars) the value of their initial investment has fallen far behind inflation! (Many would also argue that a house is not an investment!!)
- § Pay off your home mortgage as soon as you possibly can – then put some financial effort into buying income-producing assets eg shares, deposits, rental properties etc.
- § Never forget the compounding effect of interest – saving a few dollars each week for a very long time will accumulate steadily.
- § Never, ever spend more than you earn on day to day living!

Due Date Tax Returns

All tax returns are due by 7 July 2003 unless you are linked to a tax agent, myself or someone else.

In this case your return is not due until 31 March next year although you will probably want your return completed sooner so that you know your tax position.

Contact details:

Feel free to contact me as follows:

Phone: 971 1500 or 025 389 972

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