

Running Your Business –  
Your Guide to Accounting  
and Tax  
for  
Businesses

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# 1. Business Plan

## Reasons for businesses failing:

- Inadequate planning
- Poor cash management

So to make sure your business is a success you need **a Plan** and to increase the likelihood of it happening you need to **write it down**. Some of the best plans are only two pages long.

## Why you need a plan:

- ◆ Ensures you are **aware** of the major aspects and practicalities of your business eg you may have a very good feel for your product or service but little idea about the marketing side. This will become more apparent when written down. The plan should be regularly updated and may include separate detailed plans such as a detailed marketing plan.
- ◆ Credibility for income tax purposes ie so that Inland Revenue recognises that you have a viable business although it may take a few years to achieve a profit, rather than just a hobby. If the “hobby” is making a loss then Inland Revenue will not accept the deductibility of expenses. There must be an intention of operating the business to make a profit.
- ◆ Credibility with banks and lending institutions when opening accounts and borrowing money.

## What it should cover:

- ◆ What product you are selling or the service being provided
- ◆ How you are selling ie marketing, need market research, analysis of existing market etc
- ◆ Where from ie location of premises. May be home-based or from a warehouse or office, suburban or central city.
- ◆ Who – structure being used eg self-employed, company etc
- ◆ When starting – date of commencement – the affects the deductibility of costs
- ◆ SWOT analysis:
  - Strengths eg offering a mobile service or home visits, doing something which has proven demand elsewhere but isn’t being offered locally, great labour saving device, good at the job
  - Weaknesses eg not much understanding of the costing or management sides, not sure how to market product or service

- Opportunities eg being the first in the area doing it.
- Threats eg may be competition from a bigger organisation, someone may claim the idea for their own and patent it.
- ◆ Cashflow analysis: Projected cash inflows and outflows for the coming year.

### **Cash Management Tips:**

- Need to keep an eye on inflows and outflows – keep on top of billing and following up overdue accounts
- Hold off paying your own bills until your own cash has been received if possible
- Be aware of commitments eg wages due next week
- If taking out a mortgage on your own home set a limit to how much to borrow before calling it quits and cutting losses – don't gamble with your home! Make sure that if your home is being used as collateral that the loan is at domestic rates – argue assertively and shop around – banks are very willing to lend these days. Remember, a 2% difference between domestic and commercial rates on a \$50,000 loan over a year is \$1,000
- Identify the most and least profitable parts of your business – and price accordingly
- Identify costs – make sure the sale price is covering your costs. You will need to recognise the difference between fixed and variable costs ie fixed costs stay the same regardless of whether you sell anything or not. Examples are rent, interest on loans, staff wages and salaries, electricity and phone costs. Variable costs vary with the number of goods produced or the amount of services supplied. Examples of variable costs are raw materials and your own remuneration.
- Identify set-up costs – these may take you a while to recover – have a plan so that you are not always “setting up”.

## 2. Structures

### ◆ Self-employed:

that's YOU! (although you can still employ staff)

#### **Advantages:**

- You are the boss
- Simple
- Can just start up – no set-up regulations etc

#### **Disadvantages:**

- You have unlimited personal liability. That means that if a creditor starts to sue you (eg for non-completion of work to a satisfactory standard) and you lose the case then you could end up losing your home. Insurances can usually reduce this liability.
- Hard to separate you and the business eg often no separate bank account, difficulty for later sale since personally associated with the business.
- Limited opportunity to split income. Payments to spouses need to be specifically approved by Inland Revenue.

### ◆ Partnership:

that's YOU and someone else (may be up to 25 people). There is usually a partnership deed which sets out the general matters agreed such as how profits are to be distributed, division of property upon dissolution, etc.

#### **Advantages:**

- Less formal arrangement than a company and therefore less paperwork eg Minutes etc.
- Like self-employed can just start operating

#### **Disadvantages:**

- Profits are generally distributed at the end of each year although some funds may be left in to develop the business. Therefore minimal opportunity for spreading income and losses.
- Unlimited liability.

◆ **Company:**

- **Private / close:**
  - **ordinary:**
    - need only have one shareholder and director (may be the same person).
  - **look through company (LTC):**
    - is treated as a partnership for tax purposes
    - can attribute its losses to shareholders according to shareholding
    - surpluses also need to be allocated to shareholders and tax paid at shareholders' own personal tax rates.

The total shareholding may be as little as one \$1 share.

- **Public:** shares traded on the stock exchange.

***Advantages:***

- Limited liability against most creditors although personal/director guarantees are usually required for borrowings from major institutions.
- Opportunities for allocating income among years and among shareholder/employees and shareholders to maximise benefits from varying marginal tax rates.

***Disadvantages:***

- On-going cost of a separate tax return (IR4), annual return to the Companies Office (\$45) plus Minute Book recording major decisions required.
- Some set-up required eg company formation (although this need only take a couple of days), obtaining IRD number etc.

***Cost to establish and on-going:***

*To establish:* Name reservation \$10.22, Company registration \$153.33, total = \$163.55.

*On-going:* \$45 annual return fee plus cost of preparing IR4.

◆ **Trust:**

A trust is really assets held by trustees in trust for beneficiaries. The trustees decide how the assets should be used or invested to obtain the best return for the beneficiaries.

Trusts are used for two main purposes:

- Trading, and
- Protection of family assets:
  - Use to protect assets eg family home from creditors and for estate planning
  - Insurances may provide the same protection against creditors but more expensive over the long term.
  - Would only use if self-employed or owning own company. Not necessary for employees unless they own substantial other assets eg shares or want to put assets into a trust to have control over the allocation to beneficiaries or to avoid estate duty if re-imposed.

***Advantages:***

- Can allow varying distributions to beneficiaries (allowing higher distributions to beneficiaries on the lowest tax rates).

***Disadvantages:***

- Unlimited liability for trustees (unless specifically limited).
- Exposes trustees to beneficiaries. Because the assets are owned by the beneficiaries, they may later claim that the trustees have not invested the assets for the maximum return.
- Not often used for trading in NZ (used extensively in Australia) because in NZ trusts are generally taxed as for companies and there is no limitation on liability.
- Some set-up required eg should have a trust deed, need separate IRD number.
- Cost to establish

**Costs:** Around \$2,000 - \$3,000 to set up.

## 3. Accounting

### Cashbook

You should open a separate bank account for the business: cheque account and savings account, credit card can also be useful.

Then you'll need a system for recording all transactions ie receipts (monies in) and payments (monies out). This is your cashbook.

### Options:

- **Manual:**

Can use a manual cashbook such as a 16 column book from any stationer.

- **Spreadsheet:**

Set out as for a 16 column manual cashbook but done on a spreadsheet eg Excel. The benefits are that the spreadsheet does the adding calculations and allows entries to be added later if missed. Much tidier than a manual cashbook, and flexibility to design your own.

Cashbook – sample available on our website. Template ones are available for free on our website.

Spreadsheets and manual cashbooks can be time-consuming to maintain and in our experience, usually contain errors.

- **Computerised Accounting Systems:**

There are many different ones available at varying prices. Most are database systems which offer a screen and prompts for entries and allow a choice of reports to be printed from the data.

**Xero:** is an online accounting system for small to medium sized businesses. It's powerful yet simple to use and because its web based you don't have to worry about installing software on your PC, upgrading it or backing it up - its all done for you. Clients of ours that use Xero love it. You can find out more about Xero at [www.xero.com](http://www.xero.com). Costs range from \$29 a month to \$64 a month plus GST but we offer substantial discounts to our clients because we would prefer our clients use it.

**MYOB** (Mind Your Own Business): easy to use database system, only problem for larger businesses is that it doesn't accommodate branch structures. Basic version



costs around \$300, Main around \$600 and the Accounting plus is around \$800 for a single user.

**Quicken/ Quick Books:** easy to use database system, priced around \$500.

**Cash Manager:** available in two parts, cash and accrual. The cash part only gives you cash accounts, cost around \$250. The accrual (or full) one includes ability to perform accruals, calculate depreciation and print out final Income Statements and Balance Sheets and costs around \$500. Choose the latter.

**We recommend Xero for all business owners because of its ease of use, accuracy and completeness.**

### **Record Keeping**

While the cashbook system will provide a summary of amounts going in and out, you must also keep the following supporting documentation:

1. Receipts for all payments (GST invoices for amounts > \$50)
2. Copies of invoices for all goods or services provided
3. Copies of GST, FBT and Income Tax returns
4. Bank statements

File in payment number, invoice number, date order by year.

Keep all these records for 7 years. These can be kept electronically.

If you are not using Xero you should perform a bank reconciliation every month when the bank statement is received. This involves checking that both have the same information by ticking off the items on the bank statement against the chequebook and cashbook. By adding on un-presented cheques and deducting deposits or receipts not yet showing on the bank statement to your cashbook balance, the adjusted cashbook balance should equal the bank balance. Follow the reconciliation instructions on the back of the bank statement or the reconciliation below.

### **Full Bank Reconciliation:**

Opening cashbook balance at beginning of period:

*Either beginning of year, beginning of month etc*

+ Receipts for period:

- Payments for period:

= Closing Cashbook balance:

+ Unpresented Cheques:

*ie cheques written and recorded in cashbook  
as payments but not yet recorded on the bank statement*

- Uncredited deposits:

*ie receipts entered in the cashbook but not yet  
deposited at the bank according to the bank statement*

= Closing balance per bank statement:

If the closing balance calculated does not equal the balance on the bank statement,  
check all the entries from the bank statement back to the cashbook.

## 4. Income Tax

### Tax Position

**Self-employed:** You will retain your personal IRD number to record your income from self-employment. At the end of the financial year (31 March) you will need to complete an IR3 tax return. The tax rate is your own personal rate.

**Partnership:** you will need to complete an application for a separate IRD number, then an IR7 tax return. Income is generally allocated at the end of each year so the partnership has no income and pays no tax in its own right. Partners complete an IR3 and the tax rate is your own personal rate.

**Company:** you will need to complete an application for an IRD number because the company is a separate entity. The IRD number and GST numbers should be the same.

You will also need to complete an IR4 tax return at the end of the financial year and each shareholder receiving income from the company will need to complete an IR3. Tax for a company is a flat rate of 28% 1 April 2011. Amounts paid to shareholder/employees are at their own personal rates.

**Trust:** as for a company but the annual tax return is an IR6 and beneficiaries will need to complete IR3s. Tax for a trust is a flat rate of 33%. Amounts paid to beneficiaries are at their own personal rates.

### Rates of Tax for individuals

Tax rates:	individuals
From 1 April 2011:	
0 - 14,000	10.50%
14,001 - 48,000	17.50%
48,001 - 70,000	30%
70,001 upwards	33%

Rebates are available to low income earners via the Working for Families Tax Credits or the Independent Earner Tax Credit. These are organised through Inland Revenue and you need to apply to Inland Revenue for these.

### **Returns:**

Self-employed:	IR3
Partnership:	IR7 (Partners need to complete IR3s)
Company:	IR4 (If a shareholder –employee also need to complete an IR3)
Trust:	IR6 (Beneficiaries need to complete IR3s)

### **Types of tax payment:**

Two types:

- Source deduction eg PAYE, RWT which can be a final tax eg no more IR5s,
- Provisional tax if income >\$2,500 ie income of around \$24,000 pa.

### **Payment of Tax - Timing:**

#### **First year:**

In the first year of operation, depending on your earnings and the type of entity/ structure you are using, you may not need to pay any tax **during** the year, but you will need to pay tax on your first year's earnings.

If you are self-employed, a partner or a shareholder/employee, had Residual Income Tax (or RIT) of no more than \$2,500 in the 4 preceding years and have current year RIT of less than \$50,000 (ie income of less than around \$179,000 after expenses and GST), then you do not need to pay provisional tax until the next financial year.

If you are self-employed, a partner or a shareholder/employee, had RIT of no more than \$2,500 in the 4 preceding years but have current year RIT of 50,000 or more (ie income of more than \$179,000 after expenses and GST), then you need to start paying provisional tax from the next due provisional tax date or be prepared to pay the Inland Revenue Use of Money Interest (UOMI).

If you are a company or trust, then you need to start paying provisional tax at the first due date after commencement of your business.

#### **Second year and later years:**

For subsequent years, provisional tax is paid during the year based on the previous year's income with a "wash-up" done at the end of the year.

Note that the last provisional tax payment is due after the end of the financial year. Provisional tax is only payable where the RIT for the last year was > \$2,500.

There are two options for calculating the amount of provisional tax (as set out in the IRD guide to completing an IR3 or IR4):

- **Standard:** pay the same amount as last year's Residual Income Tax (RIT). That amount should be paid in 3 equal instalments on 28 August, 15 January and 7 May. If you are self-employed and are registered for GST on a six monthly basis then you pay provisional tax with your GST payments, on 28 October and 7 May. If your income tax liability has not been calculated by 28 August (or 28 October if self-employed and registered to pay GST six monthly) in any year (for example, if your accountant included your accounts in their extension of time arrangements with Inland Revenue) then you must calculate your tax liability based on 105% of the previous year's RIT.
- **Estimated:** An estimate must be made if RIT is greater than \$50,000 (income of around \$180,000). Anyone may choose to estimate their provisional tax although interest may be charged from the estimated due date until the date paid. Shortfall penalties (20% of any shortfall) may also apply if Inland Revenue considers that reasonable care was not taken in determining the estimate if the estimate ends up underestimated by more than 20%. You would generally only choose to estimate when you are expecting your income to be significantly **less** than in the previous year but we'd recommend that you make voluntary lower payments than re-estimate your tax for the year downwards as interest will be charged if your re-estimate is too low but you would have otherwise remained in the safe-harbour provisions of tax less than \$50,000.
- **Ratio:** The ratio method allows you to pay your provisional tax based on an agreed percentage of your turnover (taxable supplies) as recorded in your GST returns. The main advantages of this method are that you are only paying provisional tax on a percentage of actual earnings. This may suit seasonal workers or those on declining incomes or with lumpy income. Advantages are that no interest is payable if the correct amount is paid and it will help some taxpayers with their cashflow. However it means you need to pay provisional tax with every GST payment (you must be on the two monthly basis) and your tax for the year must be less than \$150,000. You have to have been in business for 2 years and you need to file your application before the beginning of each tax year – this is required so the correct percentage can be calculated.

### **End of Year Procedures:**

1. Add up all the cash receipts and payments.
2. Make adjustments for accruals and depreciation.
3. Prepare Balance Sheet detail ie Statement of Assets and Liabilities.
4. Complete tax return and either attach a set of financial statements (Income Statement and Balance Sheet) or complete the IR10 which comes with the tax return.

### **Critical Dates:**

1 April –

31 March: Standard tax year unless other arrangements made, industry specific or seasonal balance date.

7 July: Tax returns due for year just ended 31 March (unless your tax agent has an Extension of Time arrangement with Inland Revenue in which case the return is due by the following 31 March).

28 August: First provisional tax payment due if you are registered 2 monthly for GST or not GST registered. If tax return not yet completed, calculate provisional tax based on 105% of the previous year's tax, otherwise 100% of last year's RIT.

28 October: First provisional tax payment for 6 monthly GST registered taxpayers.

15 January: Second provisional tax payment due if you are registered 2 monthly for GST or not GST registered.

7 February: Terminal tax payment due (final tax payment for the previous year).

7 April: Terminal tax payment due (final tax payment for the previous year) if you are linked through Inland Revenue with a registered tax agent.

7 May: Final provisional tax payments due for all taxpayers – this will be the second payment for six-monthly filers and the third instalment for two-monthly filers.

Remember as an individual or shareholder employee you will not be GST registered so you will need to pay provisional tax three times a year even if your company or business only pays it twice a year.

## 5. GST

### General:

Goods and Services Tax (GST) is added on at 15% of the base price. This amount is collected by you as Inland Revenue's agent and paid over to Inland Revenue. You may offset some of this amount by claiming the GST component (at 3/23) of the cost of goods and services purchased by you in producing your goods and services.

Some items are zero-rated or exempt.

Zero-rated supplies include goods and services exported (including international travel and entertainers on overseas tours), sale of a going-concern and newly-refined precious metals.

Examples of exempt goods are financial services including bank fees and interest on loans, the sale of donated goods and services, residential accommodation, the sale of a house and the sale of other fine metals.

### Registering:

Whether self-employed, a company, a partnership or a trust, you will need to contact Inland Revenue to register for GST if you believe the value of your supplies or services will exceed \$60,000 in the year from commencement. This is the value of goods or services before deducting the costs of production. You can register online or, if registering a company, you can register for GST when setting up the company.

If there is a possibility that you will exceed the \$60,000 limit in the year then you should register for GST before you reach \$60,000. Otherwise Inland Revenue may require you to pay GST on services you have already provided but which you were not collecting GST on – this is money out of your pocket!

When registering for GST you can elect (unless you are a very large business (turnover > \$2m)) whether you would like to be on a "payments", "invoice" or "hybrid" basis. You can also select the timing of payments: either monthly, 2 monthly or 6 monthly.

**Basis:** On a "payments" basis you are liable for GST when you receive payment for goods and services and can claim deductions for amounts you have actually paid for. On an "invoice" basis, GST is due on amounts invoiced (***even though you may not have yet received payment***) and deductions may be claimed on amounts due

although not yet paid. Using the “hybrid” basis you will be paying the GST on an “invoice” basis and claiming payments when made. For a small cash-based business the payments basis is the preferred option as no GST is due until you have received the cash from the invoices that the GST relates to. If you are a retailer then the invoice basis may be more appropriate as you would like to match the cost of your goods payable on the 20 of the following month with the cash sales received.

**Timing:** Small businesses will generally choose 2 or 6 monthly. If you are disciplined about setting aside the money and earning interest on it, then 6 monthly is probably the preferred option. Paying 2 monthly however will ensure you are on top of your accounting and tax matters.

### **Non-Registered persons:**

If you are not registered for GST you do not charge GST nor can you claim it on the purchases you have made.

Purchases of **goods** from non-GST registered persons: can claim 3/23 as GST paid eg purchase of a second hand car from a private owner.

Purchases of **services** from a non-GST registered person: can't claim GST.

### **Procedure:**

Inland Revenue will send you the pre-printed forms about 2 weeks before the end of the GST period. The form needs to be sent back with payment by the end of the month following the end of the GST period eg GST period ending 30 September, GST payment due 28 October.

If you are due a refund it should be paid within 3 weeks of sending in your return. If it is a sizeable amount, expect a GST audit. Have supporting documentation for your claim but do not send it in with your claim.

You can also complete the return online through [www.ird.govt.nz](http://www.ird.govt.nz). To do this you'll need the document lodgement number (DLN) from the paper return. Filing on line is easy and convenient although you do need to have the details to hand. Many people have the paper return filled out (or one from their accounting system) and then just enter the details to the online form.

Completing the return online may speed up the issue of any refund.



## Receipts

You must always provide clients and customers with a “GST invoice” if the price of the supply (including GST) exceeds \$1,000. This must include the following:

- ◆ The words “Tax Invoice” in a prominent place
  - ◆ The name and GST number of the supplier
  - ◆ The name and address of the recipient
  - ◆ Date
  - ◆ Description of goods or services supplied
  - ◆ The quantity of goods and services supplied
- And either:
- ◆ The GST – exclusive amount, the amount of tax and the total GST inclusive amount,
- Or:
- ◆ A statement to the effect that the price includes GST.

To claim GST on purchases you have made you must obtain a GST invoice for amount over \$50. Abbreviated tax invoices may be used for amounts between \$50 and \$1,000. Abbreviated tax invoices do not need to include the:

- ◆ Name and address of the recipient or
- ◆ The quantity of goods and services supplied.

Records must be kept for 7 years for GST purposes.

Taxpayers may also elect to be on the ratio method. This method allows provisional tax to be paid when GST payments are made but is only available if you are registered two monthly for GST. Ratio method payers can then pay provisional tax based on turnover for GST purposes. The method is particularly suited to seasonal workers or those who receive lumpy income. For taxpayers who receive their income fairly regularly we believe the money is more useful to you in your bank account than in Inland Revenue’s.

## 6. FBT

The purpose of the Fringe Benefit Tax Regime is to counter the increasing use of non-taxable benefits to employees over the past decade.

Fringe Benefit Tax applies only where:

- staff are employed by the business (this includes shareholder/employees) and
- these employees receive non-monetary benefits (over and above their salaries).

Common benefits are use of a work vehicle for private use, low interest loans, free or subsidised childcare, carparks, insurance or superannuation funds etc. There is an exemption from FBT of \$300 per employee per quarter but this does not apply to motor vehicle use.

The fringe benefit tax is paid by the business either quarterly or annually.

Basically it is calculated by determining a value for the fringe benefit and applying the individual's tax rate to it. With the change in tax rates this has meant having differential rates and requiring assets that formerly may have been pooled (eg cars) to be assigned to an individual so that the correct tax rate is calculated.

Calculating FBT is the only time that the **GST-inclusive** cost of an asset is used. The value of the fringe benefit is 20% of the GST inclusive cost (or 5% per quarter).

The FBT rate is 49.25% for taxpayers on a 33% marginal tax rate for the 2012 tax year onwards.

Where FBT is paid there is no need to keep a log book.

## 7. Penalties

There are 3 main sorts of penalties for Income tax, GST and FBT:

- ◆ Late payment penalties
- ◆ Shortfall penalties, and
- ◆ Use of Money Interest (UOMI)

### Late payment penalties:

Individuals may have to pay a \$50 penalty for late return filing but late payment penalties generally apply where the amount owed is more than \$100. The amount is usually 5% of the unpaid tax and is due the day after the amount of tax was due plus 1% for every month thereafter.

### Shortfall penalties:

These apply where:

- ◆ Failure to take reasonable care: 20% penalty on any shortfall
- ◆ Unacceptable interpretation: 20% on any shortfall (the shortfall must be \$10,000 or more)
- ◆ Gross carelessness: 40% penalty on any shortfall
- ◆ Abusive tax position: 100% penalty on any shortfall where there is an unacceptable interpretation designed to avoid tax.
- ◆ Evasion or similar act: 150% penalty on any shortfall, where there has been a deliberate or known act to not pay tax or make necessary deductions.

These penalties may be reduced by 75% where there is voluntary disclosure before an Inland Revenue investigation and 40% where the taxpayer advises Inland Revenue of the shortfall after being notified of a pending investigation but before the investigation commences.

### Use of Money Interest (UOMI):

UOMI is generally charged in addition to any penalties from the day after a payment was due until the payment is made.

Currently Inland Revenue charges 8.89% per annum and pays 2.18% on amounts you overpay.

## 8. PAYE

Use PAYE where staff are employed.

Pay as You Earn (PAYE) must be calculated according to PAYE tables supplied by Inland Revenue either monthly for small employers or fortnightly for large employers. Large employers are those who pay PAYE of \$500,000 or more pa.

When you decide to employ staff (other than yourself) contact Inland Revenue and they will send you an info pack including details for registering for PAYE. They will continue to send you the forms you need monthly. You will also need to get staff to complete an IR330 when they start work for you, so you need to be organized for PAYE **before** you start employing staff.

PAYE collected in any calendar month should be paid to Inland Revenue by the 20<sup>th</sup> of the following month.

For large taxpayers, it is paid fortnightly on the 5<sup>th</sup> and 20<sup>th</sup>.

Forms also need to be completed when staff leave, and a reconciliation (between amounts deducted from employees' pays and the amount paid to Inland Revenue) needs to be performed after the end of each financial year.

New staff are automatically registered for KiwiSaver unless they specifically opt out.

Many employers prefer to use external payroll providers such as Smart Payroll or IPayroll. Cloud based these providers do all the calculations, make payments to staff and all returns for PAYE to Inland Revenue for a small cost and work really well where there are varying payments each pay period. Where a regular salary is paid and there is minimum or no staff turnover, completing the original calculations using online Inland Revenue calculators then setting up a regular automatic payment yourself and paying the PAYE with other 20<sup>th</sup> of the month payments may be easier.

### **Penalties:**

150% of the shortfall where PAYE not deducted as required and charges may also be laid against officers of the business.

### **Shareholder/Employees:**

Shareholder-employees ie those shareholders who also work in the business, do not need to pay PAYE: they pay provisional tax during the year.

## 9. Deductible Expenses

### General:

All expenses or costs necessarily incurred to produce assessable income are deductible.

These include all ordinary operating costs eg ACC, purchase of trading stock, rent payments, repairs and maintenance on business items, FBT, GST on fringe benefits, interest on money borrowed for the business, insurance, electricity, phone, postage, stationery, travel, advertising, legal and accounting advice.

Payments such as salaries and wages paid to owner/employees are deductible, as long as the payments are taxable in the hands of the recipient. For self-employed, any income, over and above costs, is personal income.

### Accruals:

Accruals recognise that in any one year the cash position may not reflect the earnings and payables of the business, just the cash in and cash out. Journal entry adjustments even out amounts earned but not received, received but relating to the previous year and ensure payments relate to the appropriate year. Depreciation is the other major accrual.

Inland Revenue requires financial statements to be prepared on an accruals basis. Doctors and barristers are the only exceptions. Preparing financial statements on a cash basis is seen as allowing opportunities for manipulating income and therefore your tax liability.

### Entertainment

Only 50% of business entertainment costs may be deducted unless the cost is exempt. An example of the exemption is food and drink available on employers' premises, lunches on courses etc.

### Business set-up costs

Business set-up costs must be capitalised and depreciated. This includes company registration costs and any legal fees regarding constitutions etc and goodwill on the purchase of a business.

## 10. Depreciation: what it is and where it fits in.

All assets purchased for a GST exclusive cost of more than \$500<sup>1</sup> must be capitalised (ie entered onto the Balance Sheet as an asset rather than being expensed in the year of purchase) and depreciated.

Depreciation is an “allocation of cost over an asset’s useful life”. It recognises that while an asset may be purchased in one year it is inequitable to allocate its whole cost to the year of purchase as the asset provides earning ability over a number of years. The allocation of the cost over several years using depreciation rates recognises this principle. Depreciation is apportioned over the year according to the number of months used in the year and is calculated using the GST exclusive cost (ie the amount less the GST paid).

Inland Revenue has already determined acceptable "useful lives" for almost all assets and these are the rates that should be used<sup>2</sup>. The rates may be either Straight Line (SL) depreciation rates which allocate the cost of the asset evenly over its useful life or Diminishing Value (DV) which allocate a higher proportion in the early years. DV amounts are achieved by calculating the depreciation each year on the already depreciated value of the asset. DV rates tend to be higher than SL rates. The choice which rate you use is yours and you may use different rates for different types of assets but you cannot change the rate except occasionally. The result evens out in the end when the asset is sold.

For example: a computer purchased in November 2011 for \$3,000.00 including GST would be depreciated for the 2011/12 tax year as follows:

Purchase price (ex GST )	$3,000 * 20/23 =$	\$2,609
Rate per Inland Revenue online calculator		50% Diminishing value
Amount of depreciation for the year		\$1,305
Amount of depreciation for 5 months		\$ 544

Therefore \$544 is the amount to be shown as depreciation if this is the only asset.

If the straight-line method was used the amount of depreciation would be \$435:

Purchase price (ex GST )	$3,000 * 20/23 =$	\$2,609
Rate per Inland Revenue online calculator		40% Straight Line
Amount of depreciation for the year		\$1,044

<sup>1</sup> Assets of a similar nature and costing less than \$2,000 may be pooled to calculate depreciation.

<sup>2</sup> Current depreciation rates are contained in Inland Revenue publication IR 260 available in booklet form from Inland Revenue. Alternatively it is available for perusal or by using the online calculator on the IRD's website: [www.ird.govt.nz](http://www.ird.govt.nz).



## 11. Vehicle Expenses

### Options

#### **Option 1: Actual expenses – applies to all sole traders and some shareholder employees**

Need to keep a log book for a 3 month period which then lasts for 3 years. This should record the starting date and km (odometer) reading in the car. Every work trip should then be recorded showing the start and finish number of kms travelled. At the end of the 3 month period the closing odometer reading should be taken. After adding the number of kms on work trips and the difference between the end and start odometer readings you can calculate the % of business travel. This figure may then be used to calculate the percentage of all other vehicle expenses over the year.

For example, if the odometer reading at 5 April was 68,000kms and the end reading at 4 July was 72,500kms and 2,000kms were used during that period on work-related travel, then 44% of all car related expenses could be claimed (ie  $2,000 / (72,500 - 68,000)$ ).

These expenses would include:

- Petrol
- Insurance
- Warrant of fitness
- Maintenance
- Tyres
- Road User Charges (RUC)
- Depreciation (calculated on the market value if a recent cost is not available),
- etc

This percentage may be claimed as a reimbursement from the business monthly, six-monthly, annually or at another period that suits you.

GST may also be claimed on all the portions except depreciation.

This method involves keeping detailed records of all expenses and is suitable when expenses are high and the business doesn't own the vehicle.



### **Option 2: Mileage rates**

Inland Revenue has prepared a set of standard mileage rates that may be used by self-employed people. These would usually apply when your **own personal car** is used for business trips.

A log of **all** business travel must be kept and mileage rates claimed for these miles. The standard rate is 77 cents per km.

### **Option 3: Full deductibility:**

Two appropriate uses:

- Use only where there is a vehicle dedicated to the business – usually a truck or van. Full deductibility may be available where there is a vehicle used solely in the business but in such a case the vehicle usually needs to have the business logo painted on it or otherwise permanently attached (not easily removable like a magnetic sign) and be large enough for the cartage of goods eg ute. Its not enough just to have your vehicle with sign-writing – it must be clearly a work vehicle dedicated to the business. Having another vehicle for personal use is also necessary.
- Use when FBT is paid on the personal use of the vehicle. In this case the vehicle is usually owned by the business and can be used privately by the shareholder employees.

All expenses associated with these vehicles may be deducted.

**Note though that a self-employed person without employees cannot use the FBT method and must always use a log book method.**

### **Option 4: No log book:**

If no log book has been maintained for the minimum 3 month period over 3 years then Inland Revenue may not allow a deduction for **any** motor vehicle expenses.

If inadequate log book details have been maintained Inland Revenue may limit the deduction to 25%.

## 12. Home Office Expenses

If you run your own business it is likely that you will have an office at home (even if you have an office at other premises).

You do not need to have a room designated as an office and a deduction for expenses may be claimed for an area that is sometimes used for your work eg a laptop in your dining room.

Some home expenses may be claimed as a business deduction based on the proportion of the home being used for the business and other expenses may be deducted according to actual or partial costs.

The most important thing is your ability to justify the proportion used and its reasonableness.

### Proportion of home:

#### **Separate office:**

If you have a separate office room then calculate the floor area of that room as a percentage of the floor area of the whole house. For example this may be around 10%. If you work mainly from home we recommend that you add on 5% for the use of shared facilities such as the bathroom and kitchen. Keep the total at 20% or less even if you use more of the house or use a large amount of storage as there may be Council by-laws against using more than 25% of the house for business activities.

#### **Office as part of a room:**

If you have an area that is set aside for office space eg part of the lounge, then calculate the area of office space as a percentage of the floor area of the whole house.

#### **Dual use space:**

If you use a room sometimes for an office and sometimes for some other purpose eg the dining room may be used for meals at mealtime and as your office during the day or at night, calculate the percentage of **time** the area is used or available for use as office space. This can be quite general eg 10% but you need to be able to justify as reasonable any percentage you use.

### **Expenses:**

When you have calculated the percentage area or time that the home is used for work, then the same percentage of the home costs may be claimed as a deduction against the business.

- **Insurance:**
  - dwelling
  - contents
  
- **Electricity**
  
- **Gas**
  
- **Water**
  
- **Rubbish collection costs**
  
- **Mortgage interest costs.** Remember that part of the total mortgage paid each month/ week includes an element of principal repayment which is not claimable. Your bank should provide a statement as at 31 March each year (although you may have to ask for it) showing the amount paid for the year broken down into interest and principal. Use this interest amount for your calculation.
  
- **Rent paid:** If claiming a portion of rent costs, can't also claim building depreciation.
  
- **Maintenance:** General maintenance costs such as plumbers' bills for blocked drains etc may also be claimed but more substantial work such as the costs of the renovation of a bathroom will be considered a capital improvement to the building and would need to be capitalised and depreciated. Therefore the building would need to be independently revalued at your cost. Inland Revenue may then require substantiation of the extent that the building portion was used as an office etc so more substantial capital works are quite a grey area. We recommend you just claim the cost of small maintenance items.

### **Other Costs (not apportioned):**

- **Phone:** If commercial rates are not being paid for a business line and a home phone is being used, then Inland Revenue accepts claims for 50% of the cost of line rental etc on the home phone. Extras such as the cost of toll calls, answer phones and calls to mobile phones may be separately claimed if they

are valid business expenses. If you are claiming 100% of mobile costs then only the home office portion of home phone and internet costs should be claimed.

- **Depreciation of office furniture and equipment**, eg office desks, chairs, photocopiers, computers and printers etc: Assets, ie non-consumable items that will still exist after a year, and which cost more than \$500 must be capitalised and depreciated. This means that the cost of the asset is spread over its working or useful life.

Calculate the amount of home office expenses and reimburse yourself. Claim GST on the total **excluding** depreciation and mortgage interest.

## 13. ACC

There are 3 parts to the ACC regime:

1. residual claims levy: this is collected by Inland Revenue to pay for the continuing cost of old claims. It is a levy on salaries and wages. The salaries and wages information provided on the IR3 (for self-employed), the IR4 (for companies), IR 7 (for partnerships), and IR6 (for trusts) is sent from Inland Revenue to ACC to calculate and invoice the employer and earner premiums. Rates of residual claims levy vary by industry.
2. employer/ self-employed premium: billed to employers by ACC, amount based on salaries and wages. Rates vary by industry and there are incentives, such as discounts for safety initiatives and training, to reduce the costs. The maximum salary on which the levy is charged for each individual changes each year.
3. earner premium: included as part of the PAYE deduction system. Billed to self-employed and companies for shareholder/ employees at a standard rate.

Minimum amounts are paid upon accident but self-employed tax payers and shareholder employees can pay an additional premium for cover-plus extra which considers cover based on actual income.

## 14. Attribution Rules (ie “80% test for consultants”)

The attribution rules effectively state that if certain criteria are met, then the income of the entity (eg company or trust) is attributed to the individual instead of the entity.

The criteria are:

- 80% or more of the entity’s gross income is derived from one organisation,
- 80% or more of the entity’s gross income is derived from one person, the taxpayer,
- the taxpayer’s net income exceeds \$70,000, and
- the business does not have substantial assets used to derive the income. Substantial assets are property that cost more than \$75,000 or at least 25% of the entity’s gross income at balance date. An example would be a courier van owner/driver.

If these criteria are all met, then the income of the entity is treated as income to the individual. Breaking one of the criteria is usually enough for the attribution rules not to apply but see the following comments from the Penny and Hooper case.

### Effect of Penny and Hooper

As a result of the court decisions on the Penny and Hooper case at the end of 2011 it appears now that even having multiple clients is not enough to allow income splitting. In cases where business income is derived from the personal efforts of an individual then 80% of the income (after necessary expenses) needs to be attributed to that individual. This is particularly relevant for professionals such as doctors, IT consultants etc who have multiple clients.

There are some exceptions where the income may not be attributed to the individual for good commercial reasons eg funds are being retained in the company for expansion purposes or capital purchases.

However if Inland Revenue believes that income has been split among lower taxed taxpayers for example by allocating a dividend to a family trust without any commercial reason especially if the income was earned from the personal exertion of one individual then it is likely to be considered tax avoidance and all the income will be attributed and taxed in the hands of the person who earned the income.

## 15. Useful Sources of Information

**Inland Revenue Publications:** Inland Revenue has published free, easy to read booklets, the IR series, on most tax topics. Refer to their website: [www.ird.govt.nz](http://www.ird.govt.nz).

**Master Tax Guide**, published by CCH and available from Bennett's Bookshop. This is a very readable reference book on all tax matters. Also available on CD-Rom.

**Staples Guide to New Zealand Tax Practice**, published by Brookers and available from Bennett's Bookshop. This text is very similar to the Master Tax Guide.

**TIBs:** Tax Information Bulletins: published monthly by Inland Revenue and available free at their website: [www.ird.govt.nz](http://www.ird.govt.nz). These provide up-to-date information from IRD on the latest court cases and IRD's position on various topics.

**ACC:** [www.acc.co.nz](http://www.acc.co.nz) : lots of information including table calculators.

**Companies Office:** [www.companies.govt.nz](http://www.companies.govt.nz): name reservations, company registrations etc online as well as a raft of business assessment tools.