



WELCOME

Winter is the busiest period of the year for accountants. Our team has had a good start and is already well into 2007 year accounts. If you haven't already done so, we encourage you to get your records in early, and ensure they are complete in order to avoid delays in preparation.

There has been great response to our continuing client activity programme featuring subjects such as Kiwi Saver and Overseas Investment Tax Changes. We hope these have been relevant to your needs and we are looking for suggestions for future events.

Economic Outlook

Our dollar continues on at a high level, especially as the Reserve Bank keeps increasing the official cash rate. No doubt at these interest levels the Reserve Bank's intention to curb inflation will slow down the market - hopefully without a crash. Fuel prices appear to be going up again despite the high dollar.

KiwiSaver is about to help get New Zealanders saving, but this appears to be too late to stop the great Aussie buy-up of New Zealand companies. With the Australian government giving a capital gain tax exemption for up to \$1M per person of superannuation contributions, their super funds will continue to have funds for further acquisition.

Again we emphasise that careful planning and budgeting in your business will minimise any adverse effects of these movements for you.

Our team looks forward to assisting you with your 2007 accounting, taxation and business management over the next year.

Best wishes,
Neil Donaldson

In this issue

Pg 2	LAQC
Pg 3	Spinning a successful yarn
Pg 4	Welcome aboard
Pg 4	Diary these dates

BUDGET INSIGHTS IN THE AFTERMATH

So how did Michael Cullen's Budget impact on you? The Finance Minister's generosity in handing out billions of dollars to boost private savings was tempered by the fact that employers will also have to dig into their own pockets to help fund the new KiwiSaver scheme. Workers for their part will not be able to access the money until they turn 65.

You've probably read a lot of Budget summaries, but hopefully the following might provide a few fresh insights.

BUSINESS

1. Corporate rate of income tax (from 1 April 2008)

The corporate rate of income tax is to be reduced from 33% to 30% from 1 April 2008. Profits retained within companies will therefore suffer less tax, but imputation credits attached to dividends will remain at 33% until 2010. There will be therefore, an incentive for trust and other low tax rate shareholders to receive dividends with 33% imputation credits when only 30% tax has been paid. The 30% rate of income tax will also apply to some qualifying investment vehicles.

2. Tax Credits for Research and Development (from 1 April 2009)

These will be given at the rate of 15% of expenditure, with credits being refunded in the event of a loss. Allowable expenditure will include salaries and wages, as well as materials and some overheads. Around the globe this generally requires the R & D to be "blue sky" expenditure, rather than product development or marketing type expenditure.

3. Changes to taxation of Controlled Foreign Companies (from 1 April 2009)

Significant changes to the taxation of offshore subsidiaries of New Zealand parent companies have been floated. They include a distinction between active (trading) and non-active (investment) subsidiaries with favourable tax treatment for the former. It has been suggested that there will be an exemption from tax for companies that derive dividends from active foreign subsidiaries. Good for those considering investing or expanding abroad, but quite a time lag before implementation.

KIWISAVER

1. Matching Employee and Employer contributions (from 1 July 2007)

The matching of employer contributions with employee contributions up to 4% is to be scrapped from April 2008. This will be replaced with the compulsory contributions (see 3. below)

2. Individuals tax credits (from 1 July 2007)

Individuals (employees and self employed) will be given a tax credit of up to \$20 per week (\$1040 p.a.) on a \$ for \$ basis for making contributions to KiwiSaver. This only applies to full timers who earn more than \$500 per week. The employee's minimum contributions to qualify for this is 4%. This means someone on \$26,000 p.a. must pay \$1040; someone on \$50,000 must pay \$2000; and someone on \$75,000 must pay \$3000. The credit is added at the end of the year.



3. Compulsory Employer contributions (from 1 April 2008)

Employers will have to match employee contributions to the extent of 1% of earnings in 2008/2009, to 2% of earnings in 2009/10, to 3% of earnings in 2010/11 and 4% in 2011/12. As compensation, the employer will be given a tax credit of up to \$20 per week (\$ for \$ up to \$20 per week) to offset this cost. Although Michael Cullen said that this would no doubt be taken into account in wage bargaining, a clever employee might wait until his pay rise has been contractually agreed before joining KiwiSaver, thus forcing the employer to pay into KiwiSaver as well. Employers might want to agree wage/salary increases with the proviso that later elections to join KiwiSaver with associated compulsory employer contributions must be funded out of those pay rises.

4. New Home subsidy (from 1 July 2010)

This does not take effect until at least three years' contributions have been made, and for this reason the rules have not been formalised or discussed. In general public discussion I have heard that the subsidy would not be given to wealthy people, but I'm unsure whether that was speculation or based on fact.

OTHER MATTERS

Property transactions - The IRD are to be given \$14m over three years to make enquiries into property transactions. This will result in close attention being paid to past and future property sales with a view to testing whether the gains should be subject to tax. Beware!

Charitable giving - The restrictions on charitable giving that used to apply to individuals and close companies has now been lifted with effect from 1 April 2008.

Reducing compliance for small businesses - We've heard it all before! And before they start to simplify it, they make it more complex - two Acts and over 300 pages of new legislation.

Limited partnership Bill later this year - To have effect from 1 April 2008, this was expected, although the prospect that limited partnerships will result in the scrapping of Qualifying Companies (including LAQCs) seems remote.



CLARIFYING THE LAQC REGIME

We regularly have clients ringing us up asking about Loss Attributing Qualifying Companies (LAQC) and asking us to form one for them. It may seem "trendy" to have a LAQC, especially to hold rental properties, but there are definite disadvantages in forming a LAQC, as well as advantages, depending on individual circumstances. So what is a LAQC, what are the advantages, disadvantages and pitfalls?

What is a LAQC?

LAQC refers to the tax status a company gains through shareholder election.

The three tax options company shareholders have are Non-Qualifying Company, Qualifying Company (QC) or Loss Attributing Qualifying Company (LAQC) status.

As the name suggests, the main advantage of a LAQC is the ability to transfer company losses to shareholders, while still maintaining most of the limited liability advantages of a company.

Once a company enters the LAQC regime it does not have the option of carrying forward losses to future years, because losses must be fully attributed to shareholders. Shareholding in the company can be set to take advantage of individual situations and minimise overall taxation.

So what are the advantages and disadvantages of LAQC status?

Advantages

- Any company losses can be attributed to shareholders, based on their shareholding. These losses can be offset against the shareholders' income, resulting in reductions of tax or tax refunds.
- Capital gains can be distributed to shareholders tax-free without winding up the company,

provided the maximum taxable dividends have been paid first.

- Non-cash dividends, such as property used by a shareholder for less than market value, will be exempt from tax.
- There can be a 100% change in shareholding without the loss of imputation credits provided LAQC status is maintained.
- Paying large shareholder salaries can eliminate overdrawn shareholder current accounts and the anti-avoidance provisions regarding excessive salaries may not be effective.
- Limited liability except for company income tax.

Disadvantages

- Additional costs of forming the company and annual compliance costs of preparing financial statements, tax returns and filing the company annual return.
- If the company becomes profitable the company will pay tax at 33% which could be higher than the individual tax rate of 19.5%.
- Getting rid of the LAQC may incur conveyancing costs and tax liabilities on depreciation recovered.
- If you have a young family and are entitled to receive Family Support, the LAQC losses are not taken into consideration when determining family income. Rental losses in your own name are, so holding the rental property in your personal name could increase family assistance entitlement.
- Shareholders agree to be personally liable for a share of any company tax liability.
- Qualifying Company Election Tax may be payable on entry into the regime if the company elects for QC status some time after incorporation and it has taxable reserves.

- Losses carried forward from previous years are forfeited on entry into the regime.
- A non-qualifying company automatically receives a tax deduction for interest costs, whereas a LAQC must satisfy the requirements of the general permission (ie. interest must be incurred in deriving assessable income or incurred in the course of carrying on a business to derive assessable income).

Pitfalls

A shareholder or director can voluntarily revoke LAQC status by writing to the Inland Revenue Department. However, a problem exists if LAQC status is unknowingly lost. This can happen in a number of situations including the death of a shareholder, shareholder changes without re-election, a shareholder who was a minor and for whom an election was made becomes sui juris (20 years of age), or there is an issue of new shares in the company to any person other than an existing shareholder.

Where an election has been revoked, or has been deemed to be so, a company will not lose its QC or LAQC status provided a new election is made within either 12 months (in the case of death of a shareholder) or 63 days in all other cases. On application, these periods may be extended by the IRD.

Shareholders need to be aware of when their elections are deemed to be automatically revoked, and ensure that a new election is made. As part of an accountant's annual review, they should check for any shareholding changes with the Companies Office - but by then the periods of grace may have expired!

Election into the regime applies from the beginning of the income year following the income year in which the IRD receive them. New companies are the exception.

The loss of QC or LAQC status is backdated to the start of the income year, and this can have adverse consequences for dividends paid in the early part of the year.

Another serious pitfall exists where an income-earning trust is considered the best place to offset the LAQC losses. The trust would own the shares in the LAQC, but when the LAQC starts making a profit the dividends MUST pass through to the beneficiaries unless LAQC/QC status is cancelled.

This could result in a tax liability for the individual if their personal tax rate is 39%.

Alternatively, upon the sale of a large and valuable asset that is to be distributed, this may have to be paid out to beneficiaries against best advice, in order to maintain QC status.

Conclusion

There are advantages of using a LAQC structure, however, they are not an automatic selection for all. You need to weigh up the advantages and disadvantages and seek advice from your accountant on your personal situation.

Glen White - Associate
glen@leech.co.nz



SPINNING A SUCCESSFUL YARN

What began as a Canterbury company focused on the manufacture of hand knitting yarn, has developed into a recognised international leader of felted yarn technology.

In just 14 years since its inception, Radford Yarn Technologies Ltd can be congratulated on coming a long way on both the local and international scene.

The progressive company, which is owned by brothers Woody and Jack Radford and long time textile guru Tony Timpson, came about largely because of Woody Radford's background in science and textiles, his work with the New Zealand Wool Board, and his belief in an important and significant future for felted yarn.

The enterprise began in a small way with the Radfords working hard to establish a solid foundation for the manufacture of hand knitting yarn.

The yarn was sold throughout New Zealand, meeting a ready demand. But when interest in hand knitting slumped, new directions were necessary.

By 2000 the principals had decided on a refocus, and with Tony Timpson now on board, began to direct their energies towards the manufacture of specialised rug and carpet yarns.

Originally operating out of premises in Hornby, the expanding business has recently seen the company shift into a new 3000 square metre factory at 27 Conaught Drive, Islington.

"We are now recognised internationally as the leader in the area of felted yarn technology," says Jack Radford, who cites the company's win of the 2005 Best Technical Yarn Innovation Award at the Domotex Flooring Trade in Hanover, Germany, as a company highlight.

"This is the largest floor coverings fair in the world and we were very pleased to be recognised in this way.

"We manufacture high quality and specialised rug and carpet yarns for rug and carpet manufacturers supplying the decorator and commercial markets internationally. We currently employ 25 full-time staff, many of whom have been with us for over five years.

"Most of the staff have extensive experience in the textile industry."

Today Radford Yarn Technologies' products are sent throughout the world.

Twenty-five per cent is snapped up by Australian and New Zealand manufacturers; a similar amount goes to the United States. Thirty per cent makes its way to the Netherlands and Germany and other European Union destinations, and the remaining 20 per cent goes to Asia.

"As most of our business is in international markets we have realised we must adopt a global mindset," says Jack.

"This means that we need to have the ability to be involved with our customers in the context of their operations and markets, and to develop products that complement and enhance their existing product range."

The instability of the New Zealand dollar, especially in relation to the US dollar, provides one of the greatest challenges to our exporting business.

"It is not so much the absolute rate that is important, but the unpredictability



Woody (left) and Jack Radford in the new Radford Yarn Technologies premises at Islington.

of the movements," says Jack.

Radford Yarn Technologies' future goals center on continuing the company's growth strategy of per cent volume per annum.

"This will be achieved by the continual investment in research and development in technical and product areas. We currently invest approximately per cent of our sales in these areas.

"Our objective is to remain world leaders in felted yarn technology."

The Radfords say Leech and Partners provides very effective support to small to medium sized businesses like Radfords.

"They have excellent support and information systems that take many of the hassles out of the ever-increasing frustration of compliance issues. Also Gary Leech's support and wise counsel on bigger issues contributes to our pool of expertise that we use to guide us on our journey."

BRIEFS

Wages paid to the spouse

Sole traders can inadvertently overlook applying to IRD for approval to increase wages to a spouse. Look out for this when completing annual financial statements. It is required for all increases except where they result from increases in award wages or general wage orders.

Got a problem with tax arrears?

If you have to pay substantial tax for back years, maybe resulting from a tax inspection, don't

forget Tax Management New Zealand has a stock of back year taxes. The purchaser stands to save both late payment penalties and UOMI. Tax Management New Zealand can usually supply back tax for several years and even if you cannot get money right back you will save about 3% on UOMI after that date. The savings can be large!

Congratulations to David and Hilary Ward

Using water in the most efficient way is one of the main reasons Mid-Canterbury arable farmers David

and Hilary Ward recently won a top award for their environmental farm practices. The couple, who run a mixed cropping unit on Singletree Rd, made history by becoming the first arable farmers in the five-year history of the Ballance awards, to take the supreme award. In addition, they also won the Hill Laboratories harvest award and the Ballance nutrient management award.

A field day will be held on the Wards' farm in spring.

DIRECTORY

ASHBURTON

PO Box 180
248 East Street
Telephone: 03 307 6688
Fax: 03 308 1203
E-mail office@leech.co.nz

CHRISTCHURCH

PO Box 13 638
Pyne Gould
Corporation Building
233 Cambridge Tce
Telephone: 03 366 2203
Fax: 03 366 1455
E-mail office@leech.co.nz

DIRECTORS

Gary Leech

027 433 7060
gary@leech.co.nz

Philip McDonald

027 435 0558
philip@leech.co.nz

Neil Donaldson

027 435 0665
neil@leech.co.nz

ASSOCIATES

Brett Dudley

DDI 03 363 6489
027 457 0535
brett@leech.co.nz

Glen White

DDI 03 363 6492
027 222 7083
glen@leech.co.nz

Chris Heffernan

DDI 03 347 6742
027 255 0805
chris@leech.co.nz

Ashburton

Perpetual Trust Manager

Matthew Hall

DDI 03 307 8752

www.leech.co.nz



WELCOME ABOARD ANNETTE AND SARAH

There are two new faces in Leech and Partners' offices in Christchurch and Ashburton this year, with the arrival of Annette Burgess and Sarah Livingstone.



Annette joined the Christchurch team in February as a qualified accounting technician - with truck and forklift licences to boot!

Born in Cheviot, she spent most of her childhood in rural North Canterbury. She graduated with a Diploma in Agriculture at Lincoln College, as it was then known,

followed by a Diploma in Farm Management.

Among other things agricultural, Annette spent time on a tractor seat, including two stints driving air seeders in Western Australia.

In recent years she has completed her Bachelor of Commerce and Management (Accounting) at Lincoln University and she aims to become a Chartered Accountant.

Annette's interests include cycle-touring, tramping and trying to keep up with her two teenage children.



Sarah Livingstone, who joined the Ashburton office in February, is busy completing her qualifications to become a Chartered Accountant.

She was born and bred in Christchurch, where she lived until moving to Hinds earlier this year.

After finishing school in 1999 she

worked for six years in an accountancy firm while completing arts and commerce degrees at the University of Canterbury.

The big OE then called, and she spent eight months working in the United Kingdom and travelling around Europe before returning home to complete her Chartered Accountancy qualifications.

In her spare time Sarah enjoys reading, playing touch rugby and six-a-side netball.

DELBRAE SHINES AGAIN

In our summer issue of the Quarterly, we made reference to the success Kauri Stables has had in the Thoroughbred racing industry.

It pleases us to be able to once again pass on our congratulations following Delbrae's win in the Canterbury

Gold Cup at Riccarton Park, a historic fixture on the calendar. This adds to their success in the Couplands Bakeries Mile last November.

A pleasing result for a local stable, congratulations to Richard Steel and trainer Sharon Robertson.

DIARY THESE DATES

We have had much interest in the events listed in our Autumn newsletter. Unfortunately, we have had to change dates on a number of them, so please see the line-up below. We have just held the Trustee Workshop with 150 attending. If you missed this and would either like the information or would like us to hold it again, please tell Jacinda. With sufficient numbers we will schedule this towards the end of the year.

JUNE

C1 Tower

The big machines are on the ground and the DVD, brochures and models are almost ready. This will be the South Island's tallest building, offering an opportunity to invest with long-lease security, income flows, capital gains and tax deductions.

Managing life's risks

Life is a journey, and it is worth planning for. This is a highly educational look at the risks faced at each life stage and hints on how to deal with them.

JULY

Carmel Fisher of Fisher Funds

Perhaps one of the most successful fund managers in New Zealand at the present time! The funds that she heads have produced consistently high returns since their

inception, with funds growing between 28% and 40% in the previous year. From 1st October it is likely that this will be a Portfolio Investment Entity and its gains will be exempt from tax with possible enhancements to returns.

AUGUST

Effective Borrowings

We hope to give you a greater insight into borrowings. Find out whether you should be reviewing your borrowings, fixing them or switching them. Learn about different methods of financing asset purchases and whether these would suit you. We also look at tax efficiency.

SEPTEMBER

Tax Effective Investments

We hope to be able to bring you an opportunity to invest in tax-effective vineyards in Australia.

OCTOBER

Meet the Fund Manager

This is pure investor education. We will have fund managers to give an economic assessment and discuss how this translates into the investment environment.

UPDATE

Previous funds offering by PIS through our seminars:

Commercial Office Fund:

A\$1.1618 - Up 16.18% on initial investment

Life Settlements Fund:

A\$1.0517 - Up 5.17% on initial investment

To register an interest in any of these activities, please contact Jacinda on 03 307 6688 or email jacinda@leech.co.nz