

# DAA Bulletin

## Quote

“The man who will use his skill and constructive imagination to see how much he can give for a dollar, instead of how little he can give for a dollar, is bound to succeed”  
- Henry Ford

**DAA**

DODD AND ASSOCIATES LTD  
CHARTERED ACCOUNTANTS

## Website

Looked at our website lately?

There have been some exciting additions in the last few weeks with more staff photos, a description of our new accounting alternative and even an up to date Rugby Diary! Go to [www.daateam.co.nz](http://www.daateam.co.nz) to keep up to date on the latest from DAA and be sure to check out Kerry's insightful, if at times controversial, comments on all the World Cup happenings.

## Inland Revenue's Compliance Focus 2011-12

Every year Inland Revenue look at particular areas where they believe taxpayers are not fully compliant with the tax legislation and this year is no exception – even in quake damaged Canterbury.

They are adamant that all measures are taken to make it easy to comply and they offer help for those that need guidance in order to do so but they are also committed to identifying those that chose not to and will use the full force of the law to assess and recover underpaid taxes.

While this may sound harsh we have to remember that all working New Zealanders contribute to the tax system and if a few individuals are avoiding paying their share then this reduces the country's tax revenue and cheats all New Zealanders out of funding for the services that support their communities – are you happy with that?

The focus for the current financial year is mainly on the “hidden economy” particularly in the hospitality, scrap metal, fishing and aquaculture, tourism and agricultural and horticultural industries. They are also keeping a close eye on online traders and short-term rental and accommodation for major events.

Technology has provided some very good tools to help in all areas being studied this year, including industry benchmarks that Inland Revenue are going to publish which will provide a helpful tool for businesses to compare their performance against. It will also provide the base from which Inland Revenue will choose businesses to audit if they fall short of these benchmarks.

Income from property transactions is also a hot topic. Inland Revenue have focused on education and raising awareness of this issue for a few years now and will continue to do so but this year they will be moving into a targeted audit response with those taxpayers who continue to be non-compliant. If you are concerned that you might have issues relating to property transactions make sure you see us as soon as possible to clarify your situation. There is still time to make a voluntary disclosure if you have made a mistake.

And finally if you suspect an individual or business of cheating the tax system or committing fraud you can report them anonymously through the Inland Revenue website [www.ird.govt.nz](http://www.ird.govt.nz) (keyword: anonymous). Remember, if someone is cheating Inland Revenue they are also cheating all us hardworking Kiwis that are paying our fair share of tax.

## Gift Duty Abolition / The Final Gift

As we forecast the draft legislation was passed unchanged; a disappointment to many lawyers who were hoping otherwise. You can expect to receive a communication from your lawyer between now and October 1 recommending a final gift and outlining good reasons why it needs to be done properly with good legal documentation. We have no problem with good legal documentation. We think this is essential. Our concern is how much the final gift should be. It is not necessarily all of any debt owed to you. Before you make any arrangement with your lawyer for this "final gift" we strongly recommend that you book a consultation with us so that we can work out with you what is the optimum amount that should be included in the final gift.

# The Penny and Hooper Tax Case

This is a sequel to our news flash e-mailed on the 24th of last month. (If you are not receiving our e-mail news flashes and would like to email [katem@dodd.co.nz](mailto:katem@dodd.co.nz) )

In our opinion elements of the mass media with an anti-trust bias have overhyped, manipulated or just straight out distorted the Supreme Court decision on this case. Headlines such as "The Death Knell Of Trusts" are an insult to good journalism.

Two Christchurch orthopaedic surgeons M/s Penny and Hooper had some years ago sold their individual surgery practices to companies owned by their respective family trusts. Each company then employed either Mr Penny or Mr Hooper as the case may be on a salaried basis to carry out the practice of orthopaedic surgery. This is quite an orthodox arrangement and many of our clients will have their business affairs structured in a similar fashion.

Inland Revenue decided that the surgeons' arrangement constituted tax avoidance and issued amended assessments. Inland Revenue's attack was under a section of the Income Tax Act which makes a scheme to avoid income tax null and void against the Commissioner of Inland Revenue. It then attempts to define what such a scheme might be and the legal arguments have all been centred on whether the arrangements adopted by M/s Penny and Hooper constituted such a scheme.

It is quite clear that a majority (if not all) commentators have not bothered to read what the judges in the Supreme Court actually had to say. As a consequence their headlines and stories are completely misleading. The judges have made it clear (very clear) that the structure was in itself not objectionable. By structure I refer to the sale of the professional practice as orthopaedic surgeons to a company owned by a family trust. For example, the judgement says:

*"the structure both taxpayers adopted when they transferred their business (orthopaedic practices) two companies owned by their family trusts was, as a structure, entirely lawful and unremarkable."*

Significantly the immediately following sentence says:

*"the adoption of such a familiar trading structure cannot per se be said to involve tax avoidance."*

And further (very significant):

*"nor is there anything unusual or artificial in a taxpayer then causing the company under his control to employ him on a salaried basis."*

What constituted the tax avoidance for Penny & Hooper was the artificially low salaries they chose to pay themselves. The judges summarised Inland Revenue's argument as

*"the commission's case is that the avoidance resulted from a single step taken by each taxpayer which took advantage of an otherwise unobjectionable business structure. That step was the taxpayers actions on each side of the employment contract relationship (as controlling director of the employer and as employee) in setting an artificially low level of salary which had the effect of altering the incidence of taxation."* and then decided that Penny and Hooper had failed to show the Commissioner was wrong.

The matter of setting salaries is something that we pay close attention to and in the light of a lot of the Judge's comments in this case we will be wanting to consult with you before final decisions are made. This may have the effect of slightly increasing accounting fees but will come with the reassurance that we are working within the guidelines set down by the highest court in the land.

## Managing the Family Trust

It has to be said that in the Penny and Hooper case the surgeons defence was weakened by their sloppy or non-existent trust management. We have been saying for a long time now that a large number of New Zealand trusts are not operated or managed to a standard expected by the courts. This makes each of those trusts vulnerable to attack. Such an attack could come from Inland Revenue but a surprising and more likely source of attack is from the beneficiaries of the trust itself. It is alarming how often a disgruntled beneficiary will launch a legal challenge against the trustees of a family trust. Perhaps this is a sad commentary on New Zealand society but it is real nonetheless.

If you have incurred the cost of the establishment of a family trust then you owe it to yourself to make sure that it is operated in a robust way so that no challenge will be successful. Trust lawyers tell us that there is a new case before the courts on trusts on average every week. The last thing you want is to be one of those. If it does happen you need to be successful with your defence. If you have a family trust and it doesn't have either a bank account or a trustee's minute book then we urge you to book a consultation with us so that we can brief you on the minimum standards required for the management of a family trust so that it can withstand the challenges.

### OUR ACCOUNTS!

As Cantabrians we are very sympathetic to the personal and business pressures the Canterbury community have been facing up to. One way this is beginning to show is with deteriorating cash flow. While we are sympathetic we are not a bank. We have to be paid – and on time. An increasing number of our customers are not paying our invoices by the due date. In the past we have responded to requests for assistance by allowing people to make agreed payments over a limited number of months at no extra cost. Some businesses are now taking advantage of our good nature and not meeting their payment obligations. If you are having difficulty paying our invoices you must talk to us about this. From now on we will be rigidly enforcing the payment terms you have agreed to with us. As a reminder this will involve, successively, automatic stop credit, automatic charging of additional interest cost and automatic referral to our new debt collection agency. In addition, to recover the additional costs that late payments cause us we will from next month be adding a \$25 administration fee onto all overdue accounts. If you are having difficulties you must let us know. This is one situation where being silent or stoic is the wrong choice. We remind you that we offer a number of alternative means of payment so there is no valid reason why any client should not be able to meet our standard terms and conditions. If you are unsure about these options for payment please contact Kate.

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