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CHARTERED ACCOUNTANTS

YOU & YOUR WEALTH CREATION

One of a series of business
advisory publications
available on request

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The information presented in this brochure is necessarily of a general nature and should not be relied upon as a substitute for specific advice. For advice on, or assistance with any of the matters raised, please contact

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The Present Climate

Congratulations!

Your business is doing quite well and you are generating at least sufficient profits to fund the levels of spending required to support your family in their chosen lifestyle. There is something extra left at the end of the year to tuck away for the future.

While New Zealand continues to be a great place to live, with a lack of population density and wonderful natural conditions and attractions, the accumulation of your property and wealth seems continually to be attacked.

You are not comfortable with the ever increasing amount of law which imposes additional obligations and liabilities on you. You are also concerned with the progressive erosion of the welfare state and the gradual shifting of responsibility for you to fund:

- Healthcare
- Children's Education
- Retirement Income
- Long Stay Residential Care

The Health system requires private insurance to obtain care for non critical elective treatment.

The education system is drifting towards a user pays basis, and tertiary education is now a significant family cost or a charge upon future earnings.

The introduction of KiwiSaver is a good first step in encouraging New Zealanders to save for their retirement, with significant subsidies provided by the Government.

Estate Duty was repealed in 1999, however the whole tax system is now complex and full of traps for the unwary. Taxpayers operate in a 'climate of fear' of incurring penalties and interest for 'getting it wrong' or 'making a simple tax mistake.'

The real measure of financial success is not high income. Real financial success is the ability to accumulate sustainable wealth.

How then do you endeavour to successfully protect your hard-earned wealth for your future plans?

Part of the answer is found in the correct selection of family entities and a **controlled** pattern of consumption.

Our Solution

The deliberate vesting of unconsumed earnings into a trust from where it can be called back, if and when required, is an essential element in the process.

The basic structure is a family trust, which owns the majority of the shares in a limited liability company, which conducts your business operations.

Kendons publication 'You & Your Trust' explains in some detail what a trust is and how it operates. Broadly, the Trustees hold assets and income in suspense for their ultimate distribution to the named beneficiaries.

The process is:

1. A budget is prepared of the amount required to meet the personal consumption of the family for the year.
2. This will generally already exist in the form of the amount which is regularly withdrawn from the business for personal living on a weekly or monthly basis.
3. That amount is grossed up for PAYE tax deductions, with those deductions being paid together with the amounts due for your staff. The net amount is paid to you when the staff wages are paid.
4. On this basis, the company should make a profit, for the amount distributed by way of salaries is now based at the personal consumption level, rather than on the profits available.
5. The company will pay tax on the profits, and will distribute the tax paid profit to the Trust as a dividend, the amount being credited as a loan from the Trust.

6. The Trust can release these funds to you when they are required for 'optional consumption' such as an overseas trip.
7. A decision on how such a release is taxed will be dependent upon the circumstances at the time. You should contact us at that time to ensure that any allocation is made in the most tax efficient manner.
8. In the meantime, the Trust is building up its loan to the company and the company can be asked to pay interest on this loan, further reducing the company profit.
9. If there is some uncertainty as to whether or not the company will make a profit or a loss after paying the PAYE salary, then a special status LAQC (Loss Attributing Qualifying Company) will be obtained by the company, with the effect that the loss is not locked into the company structure. In these circumstances the shares of the company should be held by individuals who can obtain an immediate deduction of any losses from the company against their other income.

The Results

As a Personal Taxpayer

Having your salary taxed with PAYE at source enables you to personally opt out of the provisional tax system.

Family Wealth Accumulation

Family wealth is the total of your personal capital and the Trust capital. The aim is to reduce the personal capital component of the family wealth, while at the same time increasing the Trust's component (Trust rich, personally poor).

Your personal capital is initially fixed at the level at which you sell assets into the Trust. It reduces as you make gifts to the Trust, and as you call for the funds to be paid to you to fund optional consumption.

The Trust capital continues to grow as a result of gifting, increases in asset values, and the accumulation of unconsumed income.

As a Company Taxpayer

Your company will be the one entity continuing to be a provisional taxpayer on the profits generated in excess of your salary.

As such, it will continue to be subject to the specified income uplifts on which the payments are based. It will be liable to penalties for getting it wrong if estimates are made, and it will be liable to interest on terminal tax.

On Your Business

Overall cash flow for the amount required to pay your tax will be more regular on a monthly basis, and the high payouts for the three provisional payments will be significantly reduced.

The current account concept of crediting your income to it when taxable income is known and charging your drawings will reduce. Consequently, the problems with the account becoming overdrawn and being a dividend or subject to FBT (Fringe Benefit Tax) will also reduce.

Should you need some extra personal funds, and the business is able to afford it, then as an alternative to calling upon your Trust to fund it for you, you can include a bonus and the relevant PAYE tax deduction in the monthly payroll.

The approximate annual cash flow effect of being a PAYE taxpayer rather than a provisional taxpayer is:

<u>Personal Salary Level</u>	<u>Annual Cash Flow Saving</u>
48,000	333
70,000	619
110,000	1,284

These amounts are dependent upon tax rates, tax interest rates and ACC levy rates. Models are available to determine the amounts for your own position.

In many cases multiple business entities will need to be accommodated, as will a distinction between trading and investment capital. Whether or not your family home should be sold to your family trust has matrimonial property implications upon which legal advice will be necessary.

Accumulating Wealth

Wealth is generated by increasing sustainable retained earnings to which an investment multiplier can be applied.

Accumulating Wealth is about following simple rules, including:

- Ensuring that those retained earnings are appropriately and safely invested.
- Reinvesting the income generated by those investments.
- Measuring and monitoring your performance so you know where your money is going.
- Establishing a clear goal and plan of action.
- Exercising restraint and reducing your cost of living while increasing your standard of living.
- Avoiding new debt and gradually eliminating debt.

Your Particular Circumstances

The preparation of a family Trust Deed, the relevant sale agreements and the effecting of the annual gifting programme, are also matters to be attended to by your solicitor. Such items should be in conjunction with a discussion with Kendons.

The structures you presently use will also need to be reviewed, for while there may be a desire to implement the full detail of these notes, it may be that some items come at a tax cost. In particular, care must be taken to use available imputation credits before selling your company shares to your Trust.

The best structure for you is akin to a painting. No two are the same. Each requires the effort of individual creation to provide the foundation for you to secure your aspirations and preserve your wealth.

Please contact us for your copy of one of our other Business Advisory Publications, or download them free of charge from our website at www.kendons.co.nz.

You and Your Bankers

You and Your Business Plan

You and Your Business Acquisition

You and Your Business Records

You and Your Profitability

You and Your Qualifying Company

You and Your Review of Performance

You and Your Trust

You are Thinking About Going into Business?

You and Your Wealth Creation

You and GST on Your Real Estate Transactions