NEWSLETTER

April / May 2021

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“Tough times never last but tough people do”

DB CHARTERED ACCOUNTANTS LTD

In this newsletter we cover the tax updates for residential rentals, Covid-19 small business loan, the difference between mark-up and gross profit, business cashflow, new asset threshold and minimum wage increase.

RESIDENTIAL RENTAL INVESTMENT CHANGES

Recent changes for residential property investments:

Interest Deductions on residential property income

<u>Residential Property acquired on or after 27 March 2021</u>

Where a loan is taken out to acquire property, interest on that loan cannot be claimed as an expense against your property income from 1 October 2021 onwards. The interest expense is only able to be claimed 100% from purchase date to 30 September 2021.

In addition, if money is borrowed to maintain or improve a residential property after 27 March that interest will only be able to be claimed as an expense up until 30 September 2021.

<u>Residential Property acquired before 27 March 2021</u>

Interest can still be claimed (for loans that already existed for that property) as an expense against the residential property income. However the proportion of deductible interest will reduce by 25% each income year.

For the 2022 income year interest will be 100% deductible up to 30 September 2021 and then will be 75% deductible for the October 2021 to March 2023 period. Interest deductibility then reduces to 50% for the 2024 income year, 25% for 2025 and zero for 2026.

Investors will need to consider the additional tax cost that these changes will incur.

Where an investor has a $500,000 loan at 3% ($15,000 interest per year), the deductible interest will be $13,125 for the 2022 income year (reducing to $11,250 for 2023, $7,500 for 2024 and $3,750 for 2025, $nil in 2026).

The additional annual tax cost (at 33%) will range from $620 in 2022 to $5,000 in 2026.

The change in rules will not apply where a business owner borrows against a residential investment property to fund the business or similar venture and does not apply to commercial property.

The final legislation is yet to be completed and will apply from 1 October 2021.

The Bright-line residential property test

The Bright-line test means that if a residential property is sold within a set period of acquiring it, any gain made on the property is taxable (excluding the family home). The revised bright-line property test means if property was acquired:

- on or after 27 March 2021 – gains will be taxable if sold within a 10-year bright-line period (unless it is a new build in which case it will be subject to a 5-year bright-line).
- between 29 March 2018 and 26 March 2021 – taxable if sold within a 5-year bright-line period

A new "change of use" rule is also proposed where a residential property is acquired on or after 27 March 2021 and used for both the private home and investment.
The bright-line period is generally counted from the date the property/land is transferred to the owner (generally the settlement date) and ends when you enter into a binding sale and purchase agreement to sell the property.

COVID-19 BUSINESS LOAN

The Small Business Cashflow (loan) Scheme has been extended until the end of 2023. Applications opened on 12 May 2020 and can now be submitted up to and including 31 December 2023.

Eligible businesses and organisations are entitled to a one-off loan. The maximum amount loaned is $10,000 plus $1,800 per full-time-equivalent employee.

The annual interest rate will be 3% beginning from the date of the loan being provided. Interest will not be charged if the loan is fully paid back within 2 years. If the loan is paid off within the five year lending period but after more than two years, the 3% interest rate will apply for the entire length of the loan (i.e. will be charged on the first two years also). In the event there is a default on the loan, the interest rate is increased by Inland Revenue's use of money interest rate (currently 7%).

WHAT IS THE DIFFERENCE BETWEEN MARK-UP AND GROSS PROFIT?

If your business relies on mark-up and gross profit calculations it is important to know and understand the difference between the two.

Mark-up is the percentage added to a product to determine the price;

e.g.	Product cost	$1,000
	Add Mark-up 100%	$1,000
	Sale Price	$2,000

Gross profit percentage is the resulting profit made from the sale after allowing for direct costs;

e.g.	Sale price	$2,000	(A)	
	Product Cost	$1,000	(B)	
	Gross Profit (and %)	$1,000	(C)	(50%)

(Gross Profit = "C" divided by "A" x 100 = %)

A mark-up of 100% will provide a gross profit of 50%.
A mark-up of 50% will provide a gross profit of 33%.

For your assistance, we have a schedule of mark-up and gross margin calculations available on our website which you can download for future reference at:
https://www.dbchartered.co.nz/file/schedule-of-mark-up-and-gross-margin/open

Gross Profit
Sale Price less the Product Cost

Gross Profit %
Gross Profit ÷ Sale Price x 100

CASHFLOW – DON'T FORGET TO MONITOR & CONTROL

It is always a function of good business management to ensure that you have controls in place to keep on top of cashflow. If a business is doing well, is busy and there are funds in the bank it is easy to let things drift (and if a business is having a tough time it is even more important).
Below are a few reminders on what to monitor.

Understand your Cashflow - do you know how much in costs the business will be required to pay over the next 30, 60 and 90 days including payables, loans, GST, income tax. Are you confident you will have the funds when needed?
A growing business will find that receivables and stock/work in progress balances will increase (meaning these amounts will take longer to be received into the bank). As well as this there will be an increase in wage, GST and tax costs, which will all have an impact on cashflow.

Understand your Profits - how much profit does your business generate per month? Is this enough to cover payables, loan and hire purchase payments? What parts of the business are most profitable (both as a $ or %)? Can you invest more time into areas that provide improved profit?

Accounts Receivable – is there a system to ensure that invoices are paid on time? Depending on your business you may have terms that require payment within 7, 14 or 30 days. Ensure you have a system to follow up non-payment the next 1or 2 days after payment is due. The squeaky wheel gets oiled. If you follow-up to get paid this will hopefully get your business to the top of the payments list.

Owner Drawings – if the monthly drawings/wages that owners are taking out of the business is higher than normal, are enough funds being set aside for tax?
Are drawings within what the Company can afford to pay?

Stock Control - Stock on Hand is effectively cash not sitting in the bank. Are there good controls over stock purchases so that you are not over stocked? Unnecessary funds tied up in stock would otherwise be sitting in the bank account.

Review the Information – Do you have relevant information to assess your business on a regular basis to confirm if you are on track with expectations? While it's okay to be thinking "business is going okay" or "business seems to have slowed up" what are the facts?
If you require assistance getting the relevant reports and information from your accounting system to check on progress, get in touch.

Heed the Warning Signs – there can be many signs that the cash flow situation is changing including; funds are not available to pay accounts payable on time, additional costs are being put onto a credit card, trouble meeting loan or any tax payments as they fall due. Taking action in the early stages can reduce problems further down the track.

BOOK REVIEW

SHOE MAKER- THE STORY OF REEBOK

J FOSTER

The origins of Reebok started at the beginning of the 1900's. Since that time it survived 2 world wars, family rifts, competitor challenges, production issues and of course, as is common with a growing company, ongoing financing issues.
The specialty of the company was originally running shoes and over time this developed into other sporting footwear and clothing. The US was a difficult market to crack. The book covers the actions taken and gains and losses that occurred along the way. Another good book reminding us that behind every well-known brand was a small company that started out with an idea and passion and that there is no such thing as overnight success.

ASSET PURCHASES - $1,000 THRESHOLD

A reminder that after 17 March 2021 asset purchases under $1,000 can be expensed. See our June 2020 Newsletter for further information.

MINIMUM WAGE INCREASE

The Government has confirmed that adult minimum wage will be increasing from $18.90 per hour to $20.00 per hour on 1 April 2021.

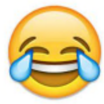
IMPORTANT TAX DATES

7 May – Third installment 2021 Provisional Tax due (March Balance Date) GST payment due (2 and 6 Monthly for March 2021)
20 May – PAYE Payment due – Payday returns to be filed 2 days after pay day
20 June – PAYE Payment due - Payday returns to be filed 2 days after pay day
28 June – Third installment 2020 Provisional Tax due (May Balance Date) GST payments due (2 Monthly for May 2021)

My boss texted me, "Send me one of your funny jokes."

I replied, "I'm working at the moment, I will send you one later."

He replied, "That was fantastic! Send me another one."



YEAR END INFORMATION

For those of you with a 31 March balance date, below is a reminder of the things to attend to for the end of the financial year:

1. **Reconcile Bank Account –** whether you use online, accounting software, spreadsheets or a manual cash book system, ensure it reconciles to the bank statement for each bank account as at 31 March 2021.
2. **Accounts Receivable –** Is your accounts receivable list accurate as at 31 March 2021? If you have any bad debts, ensure these are written off prior to 31 March (This is an IRD requirement).
3. **Accounts Payable** – All unpaid invoices dated 31 March and prior. We are able to claim these as expenses in the 2021 income year, even though they are not paid until April or later.
4. **Stock on Hand & Work in Progress -** Complete a stock-take and record stock and/or WIP as at 31 March 2021. If your stock as at 31 March 2021 is $10,000 or less you do not need to calculate a stock value – we can use the prior year figure (if your total turnover is less than $1.3 million).
5. **Computer Reports -** If you are using an accounting package save to PDF (or print out) copies of the general ledger transaction report, trial balance, accounts receivable & accounts payable and bank reconciliation as at 31 March 2021 – and don't forget to do a backup, especially if rolling into a new year.
6. **Asset List** – This is the time to go through your asset list from the previous year and advise us of any assets that have been sold, stolen, scrapped, destroyed or traded.
7. **Checklist** – Complete and sign the checklist. This is available on our website and should be included with your records www.dbchartered.co.nz/pdfs
8. **Other Information to Compile**
   - Bank interest/RWT certificates
   - Dividend statements
   - Income Protection Insurance details
   - Donation Receipts for your rebate claim
   - Details of any other income received that has not been banked to your business account

STAFF UPDATE

We recently said farewell to Charmaine who finished with us at the end March.

Thanks from the team at DB Chartered Accountants Ltd: Elaine, David, Gaylene, Karen, Kathryn, Pam & Tyler

If you would like to discuss anything mentioned in our newsletter please contact us at:

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