

Christmas Parties What's Deductible and What's Not

On the twelfth day of Christmas my employer gave to me...

If you're planning your Christmas celebration, be wary of the tax implications as not all celebrations are equal. Here's how to avoid adding a gift for the IRD to your Christmas List.

A Christmas Party will fall under the Entertainment rules and as such the expenditure is only 50% deductible. This includes the food, beverages, entertainers, room hire and other miscellaneous costs.

Those Christmas gifts that are given to employees may fall under the Fringe Benefit Tax rules. These gifts may include food such as hams, turkeys or hampers; alcohol; clothing, vouchers or other items. The gifts fall into the "other" category for Fringe Benefit Tax purposes and as such may fall under the threshold for Fringe Benefit Tax to apply.

Fringe Benefit Tax will not apply if the gift is less than \$200 per employee and no other gift has been given to that employee during the quarter. The total "other" benefits provided to employees must also be less than \$15,000 for the total of the December quarter and the three preceding quarters.

Paying Staff a Christmas Bonus

My Dad always told me son it is the little things you do for people that makes a big difference. Having lived by this philosophy all my life I can safely advise you if there is ever going to be a perfect time to pay a bonus to thank your staff, it is at



Christmas. It does not have to be a whole lot of money and it does not have to be for everyone but one thing for sure it is always appreciated and it is always remembered. So the big question is, "is it tax deductible and how much tax do you have to take out? **Simple** it is taxed at the marginal tax rate as set out in the extra emolument PAYE tables.

Would you buy this business?

Clients often ask us whether a business is worth buying. Let's look at the features that make a business an attractive proposition:

Profitability/Price relativity

What are you getting for the price you are paying? Not only is profit necessary to repay borrowings or provide a return on investment it needs to be there to provide cover against the risk of a private business. Key measures include:

▶ Return on Investment in the range of 25%-50% - Profit (after owner's wages) as a percentage of the investment required in the business across a time period.

▶ Payback period <5 years (ideally <3 years) - Another way to assess price and risk is to look at how long it will take to pay back the initial capital investment from the profit in the business. The payback period is calculated by dividing the purchase price and any associated additional capital investment by the annualised profits. The shorter the payback period the lower the risk in the investment and the more attractive it will be.

▶ Profits in top quartile for sector - Averages are unreliable but top quartile performance demonstrates how the best businesses in a particular sector perform.

▶ Earnings to revenue between 10% and 20% - This measure will vary significantly depending on the type of business. Service businesses should be able to achieve higher returns (between 15% - 20%) than retail or manufacturing (7.5% - 15%).

▶ Interest cover 3 times plus - Many businesses are funded on debt. Where there is debt funding, profits need to be greater than three times the interest cost of the loan. This not only allows a return beyond funding cost but provides a buffer if interest rates rise.

Growth capability

Where a business has evidence of a sustained history of growth the benefit is that the business you buy today has an implicit revenue increase built in and is also likely to be able to sustain a downturn.

To assess growth capability, we normally look at both the industry sector and also the business itself to determine what stage they are both in; growth, maturity or decline. A growth history of 10% is ideal.

Other key factors include the capacity within the business to accommodate further growth without substantial investment; and the extent to which growth can be managed as a variable cost rather than fixed cost. Managing growth as a variable cost lowers the risk.

When assessing a business's growth capability, the existing client base and product range are also important factors. You need to be able to identify the business's point of differentiation and sustainable competitive advantage. Where these exist, growth is more likely to be sustained.



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Resource availability

The availability of resources such as product, labour, capital, and technology are important to any business. A scarcity of resources impinges on growth and a limited number of suppliers makes the business unreasonably dependant. Ideally, the resources required by the business will be in ready supply from a choice of suppliers, there will be an opportunity to achieve economies of scale where volume purchases are made, and resource supply is scalable as the business grows.

Manageable risk

Increasingly businesses are risk assessed by purchasers. The bigger the investment and the greater the proportion of the purchase price that is attributable to goodwill and intangibles, the more risk is an issue.

When assessing risk we look for evidence of both a compliance history and the existence of operational risk management systems. In addition to the risk management systems of the business, we also consider the risk profile of the business generally and the risks attached to the products or services supplied by the business.

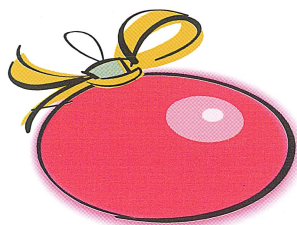
Ownership demands

A business that is highly dependant on its owners might be performing at a high level but this might be a result of the input of the owners. Where this input is substantially in excess of normal parameters and where a buyer is not prepared to maintain this level of input, there will be a financial effect. We look to ensure that the business has a reasonable level of infrastructure support and can return a viable result when the owners are working reasonable hours, are not unduly stressed, and are able to take leave.

Quote of the month

Do more than is required. What is the distance between someone who achieves their goals consistently and those who spend their lives and careers merely following? The extra mile.

By Blair



How would the fair dividend rate work?

Individuals would apply the "fair dividend rate" based on the market value of shares held at the start of the year. That is, if an investor holds \$100,000 of offshore shares at the start of the year, their taxable income would be \$5,000 (unless they are able to show that their investment has returned less than 5 per cent or has made a negative return).

Examples

Where an individual makes a total return of more than 5 per cent

John holds offshore shares that have a market value of \$100,000 at the start of the year. These shares are worth \$115,000 at the end of the year. John also derives a \$10,000 dividend.

Under the fair dividend rate approach, John would either pay tax on 5 per cent of \$100,000 or a lower amount if his return for the year is less than 5 per cent. No tax would be payable if he made a negative return.

John's total return for the year is the \$15,000 capital gain on his shares and the dividend of \$10,000. His total return is therefore \$25,000. However, his taxable income for the year would be limited to 5 per cent of the opening value of his shares. This would result in taxable income of \$5,000. (Note: under the fair dividend rate method dividends would not be separately taxed)

Where an individual makes a total return of less than 5 per cent

Mary's total return for the year is \$3,000 (comprised of a capital gain of \$2,000 and a dividend of \$1,000), which is less than 5 per cent of her opening value of \$100,000. Therefore,

Mary would only be taxable on \$3,000.

Where an individual makes a negative return

Judy's total return for the year comprises a capital loss of \$25,000 and the dividend of \$10,000. Her net return is therefore a loss of \$15,000. Because Judy has made a negative return on her offshore shares, no tax would be payable under the fair dividend rate approach.

Why set a 5 per cent rate?

This represents a realistic rate based on historical returns on equity investments. These have averaged around 8 per cent over the latter half of the last century.

Will the \$50,000 threshold still apply for individuals?

They are not proposing to change this.

How would the fair dividend rate apply to managed funds?

In order for managed funds to apply the new rules simply it is necessary that they know what the fair rate of return is at the beginning of a period. Therefore, managed funds would use a version of the fair dividend rate method that would tax 5 per cent of the value of their offshore portfolio share investments each year. There would be no variation to this rate, to provide certainty, and also to limit the potential fiscal cost.

XMAS HOURS

HWI will be closing on Friday 22 December 2006 and re-opening on Monday 15 January 2007.

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helping with your business is our business