PAKIHI TOI

Module 8

Ngā tāke

Tax

Weaving your creative passion and business

Creative Waikato
Toi Waikato

ME WAIA HAERE KOE KI NGĀ ĀHUATANGA O TE TĀKE. MĀ TE ĀTA TIAKI I NGĀ REKOATA KAUTE O NGĀ PŪTEA E KUHU MAI ANA E PUTA ATU ANA HOKI KA MĀMĀ AKE AI TŌ UTU I NGĀ TĀKE I TE WĀ E TIKA ANA.

If you're a creative (which we assume you are if you are reading this), there's a pretty big chance tax doesn't excite you. Join the club.

But once you embark on your own business, it's something you've got to get your head around early, or it can really trip you up.

The easiest and best way to avoid tax headaches is to get a good accountant early.

Sometimes people avoid accountants because of the cost, but believe us when we tell you they are worth every cent. If you stay organized and keep good records, your accountant shouldn't have to do too many hours on your accounts, and will ultimately save you money with great advice, freeing up many hours for your creative practice.

Make sure you find an accountant who really understands you and your business. They'll let you know the business expenses to claim (like your studio space at your whare or materials you use), and of course you can deduct the accountant's fee as a business expense. Lots of businesses use MYOB or Xero, so check in with your accountant that you've got the same program.

As well as tax advice from accountants, there's a heap of info around. IRD run free workshops to teach you about your tax actions as a business owner. For our rohe they are delivered in Kirikiriroa and Tokoroa.
Find out when then next one is at:
www.ird.govt.nz/contact-us/seminars/waikato/

It's useful to remember that the IRD are keen to see you get your tax right. They have heaps of useful rauemi on their website. You can even book in an hour-long one-on-one session with a tax adviser, who will help you to get your head around tax.

Getting into good financial habits early on will save you from a lot of headaches later. As soon as you're earning pūtea, put aside the amount of tax you'll need to pay on it into a separate bank account. Remember: Don't touch! This will save you from getting in a panic at the end of the financial year.

Getting into the flow of keeping good financial records, filing away receipts, tracking logbooks and streamlining your processes saves you loads of time in the long run. Doing it as you go is a million times easier than rushing at the last minute.

If you aren't ready to pay for an accountant yet, make sure you do get one at the point that you're earning enough that you're asked to pay provisional tax.

We'll talk about provisional tax in Section 8.2.

No matter what business structure, we all need to pay income tax.

How much tax you need to pay is worked out from your net income. This is your gross income minus your expenses.

Gross income means everything that you earned. When you take off all your business expenses, that's your net income. If you want to remember which is which, you can imagine a net catching some but not all of the fish!

8.1

For example, if you made sales of $100,000 in one year, and you had business expenses of $60,000, you would need to pay income tax on $40,000.

Sales:	**$100,000 (gross income)**
Expenses:	**-$60,000**
Total to pay tax on:	**$40,000 (net income)**

And remember, a good accountant will be able to tell you all the things you can claim as expenses, reducing the tax you pay. There can be more than you'd imagine.

Individual income tax is calculated using the following rates:

$1—$14,000 = 10.5%

$14,001—$48,000 = 17.5%

$48,001—$70,000 = 30%

$70,001 and above = 33%

This works on a sliding scale. For example, if you filed $40,000 net income you would pay 10.5% on the first $14,000 ($1,470) and 17.5% on the remaining $26,000 ($4,550). The total tax to pay would be $6,020.

These tax rates don't apply to companies. Companies pay a single flat tax rate of 28% on their net income.

Here's a calculator to work out tax for individuals. As a sole trader, you can use this calculator to work out the tax you'll pay by entering your net income.

When you're in business for yourself, you may need to pay provisional tax.

This is a way of paying your income tax throughout the year instead of at the end of the year in a lump sum.

You pay in three installments throughout the year, based on an estimate of what you're earning. At the end of the tax year, you deduct the provisional tax you've already paid from the amount you owe for tax. In other words, provisional tax helps to spread out the payments by paying them before the end of the tax year.

Anyone who pays more than $2,500 residual income tax for their business in one year will have to pay provisional tax in the following year. Residual income tax is what you have left to pay after all other tax credits have been deducted. Let's say you earn both PAYE and self-employed income. Once your business expenses and the tax already paid from your PAYE are deducted, what's left over is your residual income tax.

When your business has grown to the point that you're paying $1500 or more residual tax, it's a good idea to see an accountant to plan for when you have to start paying provisional tax. There is a changeover period between the two payment methods that gets a lot of new businesses into hot water. Heads up!

Once you're paying provisional tax, definitely get an accountant. They will calculate your provisional tax for you and remind you when it's due.

When you earn wages, your tax is referred to as PAYE — Pay as You Earn.

As part of that system, deductions for ACC levies, student loans and Kiwisaver are nicely taken care of for you. Lucky!

Now that you're in business, you're responsible for working out and making these payments yourself.

Here is what you'll need to do.

ACC

When you start out as a sole trader, you're automatically on ACC's CoverPlus. What you pay will be based on the type of work you do (some work is more accident-prone than others) and your liable earnings. Once a year you'll be invoiced for ACC levies (fees for providing accident cover).

As a small business or company owner you'll pay an ACC Work Levy each year, which provides cover for you and any employees.

How much your business pays depends on:

- Your type of business
- How much you pay your employees (if you have any)
- The number of work-related injury claims your business has made previously

You can work out how much your levy is likely to be by using ACC's levy calculator.

Student loans

If you're self-employed you need to make your own student loan repayments. How much your repayments will be depends on your net income—the amount that you earn in a tax year, minus your expenses.

You'll only have a repayment to make if:

- Your adjusted net income is $1,500 or more, and
- Your total income is $20,948 or more (including salary or wages)

The Inland Revenue Department site has information on how to calculate your repayment.

KiwiSaver

KiwiSaver is very flexible for self-employed people. You're not required to contribute a set percentage of your pay. Instead you can agree on your contribution level with your KiwiSaver provider. Some providers may have minimum contribution requirements.

You can either:

- make lump sum payments when you choose, or
- set up regular payments

Recording and claiming expenses can save you heaps of money. Expenses are an important part of your tax calculation.

When filling in your tax return, you record your total sales for the year and take off your business expenses. This gives you your net income. You pay income tax on this, not on your gross income. You also pay tax on any extra income.

Sales:	**$100,000**
Expenses:	**-$60,000**
Total to pay tax on:	**$40,000**

You need to keep a record of your expenses as you go. A cashbook is good way to keep track of your income and expenses. You also need to keep copies of all invoices and receipts for seven years. You can keep records electronically, so snap a photo of them or scan them and keep them in a Dropbox folder or on a flash drive.

Keeping good records will help you to run your business better by:

- giving you a clear idea of how things are going
- making it easier to raise finance
- protecting yourself against stress if you are selected for an IRD audit

The two main types of expenses are revenue expenses and capital expenses.

Revenue expenses are incurred in the day to day running of the business. Some examples: power, petrol, rent, stationery, paints and materials.

Capital expenses are big ticket items that you would keep in your business for longer than a year (like a computer or laptop, a car or machinery). You can't claim the full cost of these when you buy them as an expense. But you can claim depreciation (see next section).

An item is a capital expense if you answer yes to these two questions:

1) Is the value of the item more than $500?

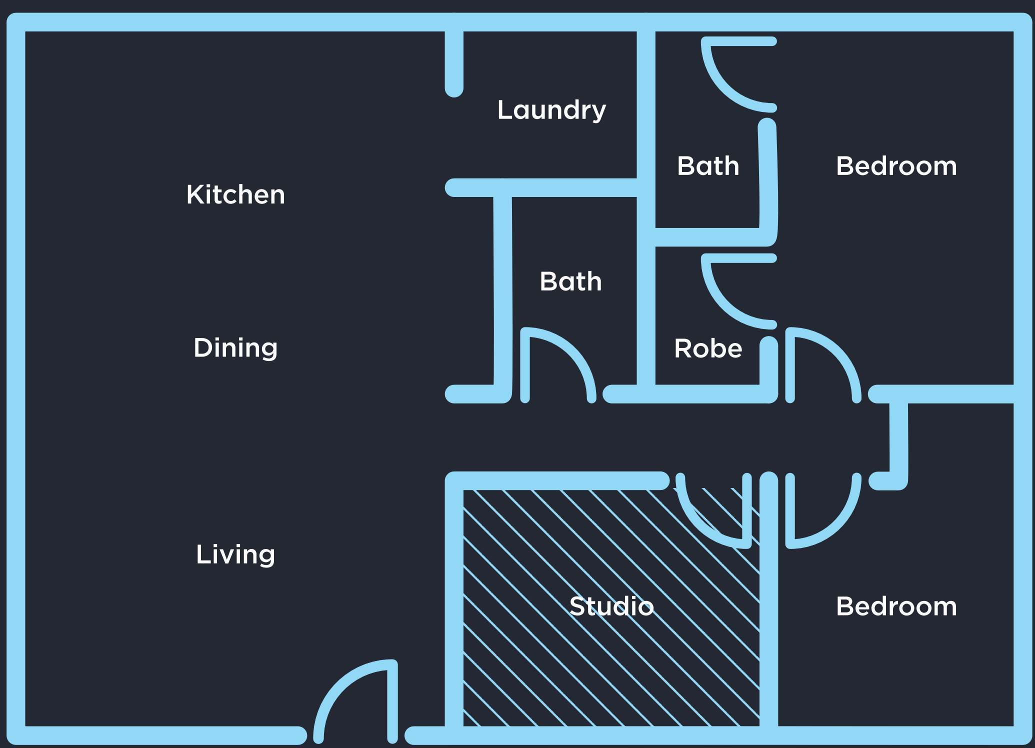
2) Will the item last for more than 12 months?

If you answered no to either question, the item is probably a revenue expense instead.

Expenses can be deducted from your tax bill only if the expenses relate to your business. Private expenses can't be deducted. If the cost is partly business and partly private, you can only deduct the business portion. This is called a private use adjustment—you're adjusting based on how much of the expense is for private use.

Erina has set aside a room in her whare to be used exclusively as an office for her business.

This means she can claim a percentage of her household expenses in her tax return. These expenses include rates, insurance, power, phone, internet and rent or interest on the mortgage. To work out the percentage to claim, Erina needs to calculate the floor space of her office as a percentage of the total floor area of her whare. If Erina's office works out to be 15% of the total floor area, then she can claim 15% of the household costs as an expense.



Another common scenario is where the car for the business is also the whānau car.

In this case you need to keep track of the use of the car over three months in a log book. Then you can calculate the percentage of use that was for business—this is the portion of the total running costs of the car that you can claim as an expense. You can use this percentage for three years before having to keep another log book for three months again.

You may also need to make private use adjustments for entertainment and business trips. Pātai atu to your accountant or the IRD for more info on this.

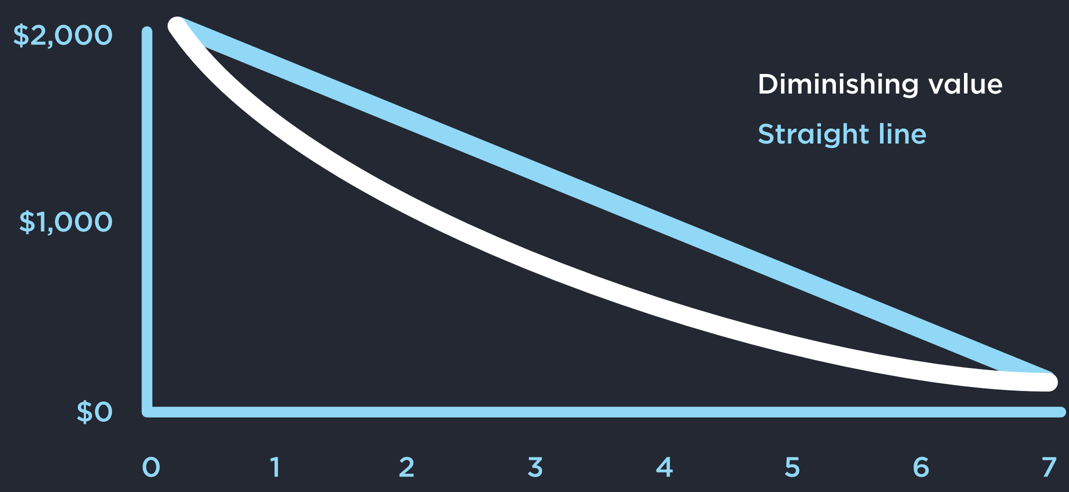
Depreciation reflects the way that capital items (big ticket items) you use in your business lose value over time.

When you buy something for your business that costs over $500, it's a capital expense (like an expensive laptop). Rather than claiming the whole cost straight away, you claim depreciation over time.

If you own capital items in your business, you need to keep a register showing the cost price, the depreciation claimed and the adjusted tax value (cost price minus the depreciation claimed each tax year).

Depreciation can be calculated in two ways: either through diminishing value or the straight line method.

VALUE OF A FANCY LAPTOP



Diminishing value takes a deduction based on the adjusted value, so each year you claim less and less as the item loses its value. An advantage to this is you get to claim more in the first year.

Straight line method takes the same deduction each year until the item's value is reduced to zero. The advantage to this method is you claim the full cost of the item over a shorter time.

The rates for both calculations can be found at the Inland Revenue's website.

(To be honest the easiest way is to get your accountant to work it out—you just need to understand why they are doing it.)

In business, depending on how much you make as a gross income, you may need to register for GST (Goods and Service Tax).

GST is a tax added to the sales price of most goods and services. If you are registered for GST you need to collect GST from your customers and pay it to Inland Revenue. You can also claim a credit on GST you pay on your business expenses.

8.6

When do you need to register?

You need to register for GST if:

- Your gross income in the last 12 months was more than $60,000, or
- You expect your turnover for the next 12 months to exceed $60,000.

If your turnover is $60,000 or less, you can register voluntarily. But make sure it is the right decision for you.

An advantage can be claiming credits on the GST you are charged for business related expenses (say you buy paintbrushes, you can claim back the 15% GST you paid). Some disadvantages are that you have more paperwork to do, you need to file extra regular returns, and you run the risk of having interest and penalties for any late payments.

Filing

If you are GST registered, you can choose to file monthly, two-monthly or six-monthly. You can also chose if you pay and claim GST when invoices are made (in advance) or when payments are completed.

Running a successful business means you need to make time for record keeping.

You need to keep a record for every transaction, including cash sales and expenses. It’s worth getting into the habit of recording sales and expenses when they happen.

The most basic way to do this is to get a notebook and put in all your income and expenses as they happen, including amount, date and what the pūtea is for. Label an envelope and put all your receipts in it. This will get you started while you set up a proper system. The better your system is and the better you keep up with it, the easier your life is going to be when tax time rolls around.

Many people use a simple spreadsheet or cashbook with separate columns for income and expenses, separated into months. This can be done electronically to make it easier. Here is an example from the IRD website.

Keeping a backup of your records is important too. Receipts fade, so definitely take photos or copies of these and put them all in one place, organized by tax year. All records must be kept for seven tax years, just in case you get picked randomly by IRD to be audited.

Many business owners use accounting software because it makes life much easier. Popular accounting software includes Xero (www.xero.com/nz/) and MYOB (www.myob.com/nz).

Make sure your accountant can work with the software you use.

Financial statements

Financial statements are records that clearly outline the performance and strength of your business.

Most businesses prepare a profit and loss statement and a balance sheet. The profit and loss statement shows gross income, expenses and net income (profit). You include your net income in your income tax return. The balance sheet shows the business assets and liabilities at the end of the tax year.

Financial statements need to meet the minimum reporting requirements to ensure you pay the right amount of tax. You can find out more about these requirements on the IRD website.

Getting help

Tax can take a bit to get your head around. However, in addition to the information on our rauemi page, there are some great rauemi to help you:

- Inland Revenue run free tax seminars. Visit www.ird.govt.nz/contact-us/seminars for dates and places.
- IRD also have tax advisors who can meet with you to help you understand your tax responsibilities.
- There are some handy resources for people setting up new businesses here.

AHAKOA KEI WHEA KOE I RUNGA I TŌ HĪKOINGA PAKIHI, E TINO HIAHIA ANA TE TĪMA O CREATIVE WAIKATO KI TE RONGO MAI I NGĀ RINGATOI KEI TŌ MĀTOU ROHE. KUA UTUA MĀTOU KI TE AWHI I NGĀ RINGATOI, NŌ REIRA ME WHAKAPĀ MAI KI A MĀTOU.

No matter where you're at in your business journey, the team at Creative Waikato love hearing from artists in our region. We're here to help, so please don't be a stranger.

Creative Waikato
Toi Waikato

hello@creativewaikato.co.nz | 0508 427 8927 | creativewaikato.co.nz