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MAXIMISING YOUR INCOME IN THE LOWER TAX BRACKETS

(by Chris Shaw, Rural Adviser, McIntyre Dick and Partners)

Many farmers will be facing quite significant drops in taxable income in this current year compared to that achieved in the last couple of years.

So What Does This Mean?

For some they will see their top rate of tax drop from 39 cents in the dollar down to within the 15 cents in the dollar marginal tax rate bracket.

Just a reminder that the basic annual rates of tax for individuals for the 2004 are:

- For income not exceeding $38,000 19.5%
- Income exceeding $38,000 and not exceeding $60,000 33.0%
- Income exceeding $60,000 39.0%

For those entitled to the low income rebate the effective marginal tax rate for the 2004 income year is 15% for income not exceeding $9.500 and 21% for income between $9,500 and $38,000.

Smooth Out and Gain

Hopefully this drop in income will only be temporary and farm incomes will again be on the rise in the not too distant future. If this is expected to be the case then consideration should be given to maximising the income threshold within the lowest acceptable tax bracket.

This smoothes out the income stream over a number of years and ensures a more consistent rate of tax over that timeframe.

For many, they may be comfortable in fully utilising not just the lowest marginal tax bracket but the second lowest bracket. This could see future income that may have otherwise have been taxed at 39%, taxed at 21% if there is an entitlement to the low income rebate.

For others, simply bringing a loss back to a breakeven position may be acceptable.

Boosting Your Income

So how do we push up this year's income to fully utilise the lower tax brackets.

Income Equalisation Scheme Refunds:
A number of farmers with incomes in the 39% tax bracket in recent years have placed funds in the Income Equalisation Scheme. This gave them a tax deduction of 39% on these deposits at that time. When these deposits are refunded they are treated as taxable income generally in the year in which the refund is requested. If this happens to be in a year of low income, the resulting tax liability will be significantly less than the 39% deduction obtained when the deposit was made.

Generally refunds will not be made within twelve months of deposit, however you can apply for a refund six months after deposit to:

- Undertake development or maintenance work
- Purchase livestock
- Avoid serious hardship, or
- For any other reason, at the discretion of the Commissioner of Inland Revenue.

In cases of extreme hardship or an adverse event, a deposit may be refunded within six months of it being made.

Aside from the resulting tax benefit, the farmer will receive a boost to their cashflow that is also likely to be significantly down as a result of their reduced income.

Spreading of Fertiliser Costs:
A farmer is able to spread the cost or purchasing or applying fertiliser or lime from the year in which it is incurred to all or any of the 4 subsequent years.

Taxpayers eligible for the deduction spread must be engaged in any farming or agricultural business in New Zealand. It therefore applies not only to those farmers who actually own the farm property but to any lessees of a farm property as well.

The farmer may elect to deduct any portion of the deduction spread in each of the four years after the expenditure was incurred – it need not be spread equally in each of the years. The deduction spread must be fully completed by the fourth subsequent income year.

What happens when I am in a partnership? Where members in a partnership have made a deferral, they make the spread in the four subsequent years individually. It does not have to be the same for all the partners. This allows for greater flexibility particularly where one or more of the partners have varying income streams from other sources.

Think Now and Plan Before Your Next Tax Instalment

It may seem strange that the income tax position is not minimised in the year of falling incomes and cash flows, however the bigger picture and savings achieved by balancing the overall tax take over a period of time may have a greater advantage.

And even though the current year income is being pushed up, it is still likely to be lower than the previous year. Consideration should therefore be given to estimating this year's taxable income and reducing provisional tax payments and the cash outflow accordingly.