Tax Impact of Lower Product Prices

We have been reviewing the taxation impact of the rural downturn and more particularly the steps that farmers can take to address their tax position:

1. New Zealand's taxation system works on the basis that the government assume that all taxpayer's income will increase by 5% from the previous tax year and require all taxpayers with a minimum tax obligation of $5,000, to pay provisional tax for the year ahead.

2. Where it is obvious that incomes are not likely to increase by 5%, it is possible to estimate your tax position.

3. In many instances, it is hard to envisage any profit being realised from the farming operation and as a result, it is possible to estimate provisional tax at zero.

4. In some cases, depending on current business structures, some of our farming clients continue to pay a minimum level of tax, recognising that they are better to pay tax at a lower rate now, rather than what could potentially be a higher rate later. This is probably best explained by way of an example:

   Mr and Mrs Farmer operate under a company structure and have taxable profit for the year to 30 June 2023 of $146,000.
   In the year to 30 June 2023, they allocate shareholder salaries to themselves of $48,000 each at an average tax rate of 15.45% and the remaining $50,000 is taxed in the company at the company tax rate of 28%.
   With the current downturn in income expected from the farm they are now anticipating a small loss for the year to 30 June 2024.
   Mr and Mrs Farmer have the opportunity to estimate 2024 provisional tax at nil for both the company and themselves personally.

Rather than take this option they have elected to continue to allocate themselves a shareholder salary of $25,000 each and pay provisional tax for the 2024 financial year at an average tax rate of 13.5%. They elect to estimate the company tax rate at zero.
They have elected to adopt this position as they consider that when the farming cycle improves, they anticipate a higher level of income. By allocating themselves a salary of $25,000 each they are pushing the company into a further loss position of at least $50,000.
This loss will then carry forward to future years where they anticipate they will again generate healthy income. In the event they generate income of $146,000 in a future year they will then continue to allocate themselves $48,000 each totalling $96,000 and the balance of income will not be taxed in the name of the company as the company will have $50,000 of losses to offset against this income. The net effect is to reduce future liability that would have been taxed at 28% down to 13.5%.
Obviously, this is dependent on current cash flow which may override any desire to save potential taxation.

5. A further option available is to consider the income equalisation scheme. This again can be explained by way of example:

   After allocating themselves salaries, Dairy farming clients record taxable income of $500,000 for the year to 31 May 2023 (recognising solid retro payments from the previous season). Tax on this income at the company tax rate is $140,000 at 28%.
   Our clients have calculated that the payout needs to be $7.90 per kgms before allocating themselves the same level of salary in the year to 31 May 2024.
   Anticipating a taxable income for the year to 31 May 2024 based on $7 a kilo will result in a loss of $200,000.
   Our clients elect to deposit $200,000 into the IRD income equalisation deposit scheme (which returns 3 percent interest after a 12 month period). This reduces our clients current tax obligation by $56,000. They are also able to estimate the company provisional tax obligation at zero.
   When they elect to withdraw the $200,000 from the IRD income equalisation scheme the deposit offsets the loss that they incur for the year to 31 May 2024 and there is no tax obligation payable on the withdrawal of the $200,000.
   In our experience, banks are comfortable advancing additional funds for income equalisation deposits on the basis that these funds are deposited with the government and on the basis that they are applied immediately to repay debt on withdrawal.

Please feel free to call us to discuss your tax position and determine what options are available to you.

An Inflation-Adjusted Look at the Payout History of Fonterra's Dairy Payout

We have attached below a graphical representation of the dairy payout from 1993 through to 2023 (assuming 2023 is unchanged from forecast).

Some comments from those with a hyperactive analytical brain:

1. The average inflation-adjusted return in the last 30 years was $7.43 (lifted somewhat by the average inflation-adjusted payout over the last 15 years being $8.14)

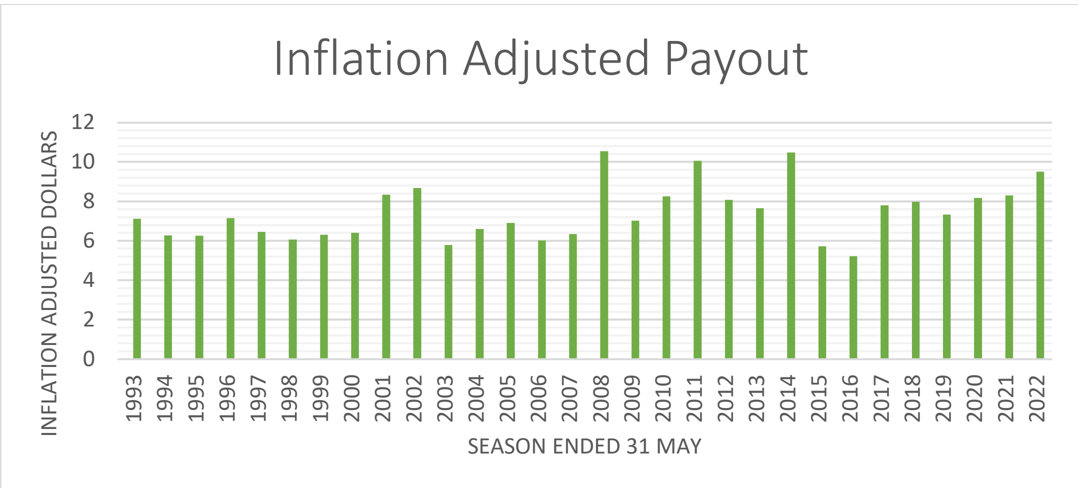
2. The highest payout in inflation-adjusted terms was $10.54 in 2008 (dropping by 1/3 to $7.02 in the next season)
3. The largest ever drop in payout occurred from 2014 to 2015 where the inflation-adjusted payout dropped from $10.47 down to $5.72 (a 45% decrease)
4. The current costs including wage allowances for owners appears to be around $6 per KG before allowing for interest costs.
5. At an average $19 per kg of debt recorded in the dairy sector, interest costs have risen from. Circa, $0.60 per kg to circa, $1.50 per kg

Fonterra Farmer Payout History (Adjusted for Inflation)

Season Ended 31 May	Actual Payment Including Dividends	Payment Inflation Adjusted (In Dec 2022 Dollars)
1993	$3.66	$7.12
1994	$3.32	$6.28
1995	$3.40	$6.25
1996	$3.99	$7.15
1997	$3.63	$6.45
1998	$3.42	$6.06
1999	$3.58	$6.31
2000	$3.78	$6.41
2001	$5.01	$8.34
2002	$5.35	$8.67
2003	$3.63	$5.79
2004	$4.25	$6.60
2005	$4.59	$6.91
2006	$4.10	$6.02
2007	$4.46	$6.34
2008	$7.66	$10.54
2009	$5.20	$7.02
2010	$6.37	$8.26
2011	$7.90	$10.06
2012	$6.40	$8.07
2013	$6.16	$7.65
2014	$8.50	$10.47
2015	$4.65	$5.72
2016	$4.30	$5.22
2017	$6.52	$7.80
2018	$6.79	$7.97
2019	$6.35	$7.32
2020	$7.19	$8.17
2021	$7.74	$8.30
2022	$9.50	$9.50

Summary – In Inflation Adjusted to Dec 2022 dollars

Average Payout:	Last 30 years		$7.43
Average Payout:	Last 15 years		$8.14
Highest Payout:		2008	$10.54
Lowest Payout:		2016	$5.22



Accounting Opportunity

If you have a son or daughter contemplating further study at university, please be aware that there are alternatives to heading to university on a full-time basis.

We are on the lookout for a school leaver who is from a rural background to join our HC Rural team.

We are flexible in terms of arrangements and are happy to negotiate an arrangement where your son or daughter would work part-time at HC partners while also undertaking further study extramurally.

We see this opportunity as providing an alternative to the well-worn path of paying $25,000 per annum at a hall of residence, racking up a huge amount of student loan and then hoping to pick up an accounting job after the end of university study.

If you have a son or daughter in this position or know of someone, please call the respective director who you would normally deal with at HC Partners.

CONTACT OUR TEAM

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