

2010 Budget Summary

No two ways about it, the May 2010 budget was about tax, and some of the issues raised will take some time to understand and there will be more discussion papers coming out in the future. For more detail on specific areas, go to the link below where you will find media statements, fact sheets and issues papers.

<http://www.taxpolicy.ird.govt.nz/>

1. Personal Tax cuts from 1 October 2010. From 1 October 1, the tax rates will be:

Income	Current rates	New rates
\$0 - \$14,000	12.5%	10.5%
\$14,001 - \$48,000	21.0%	17.5%
\$48,001 - \$70,000	33.0%	30.0%
Over \$70,000	38.0%	33.0%

For individual provisional taxpayers provisional tax payments made after 1/10/10 will be adjusted to take account of the lower tax rates. There is nothing to stop individual taxpayers who are already subject to IRD interest on their provisional tax from estimating their tax down for the August 2010 payment, effectively taking the tax cut a little earlier. If you are under the threshold for IRD interest on shortpayment of provisional tax (currently, provisional income of approximately \$160,000), caution in estimating tax down is recommended.

This tax rate reduction will also flow through to other taxes like FBT and RWT to retain consistency.

2. The current redundancy rebate will be removed from 1 October 2010.
3. The superannuation fund withdrawal tax will be removed. This was an anti-avoidance measure brought in to stop individuals undertaking large salary sacrifices to pay their salary into a superannuation fund and subsequently withdrawing from the fund, and is now largely irrelevant.
4. Attribution rules for single shareholder companies that derive 80% or more of their income from personal services provided to one customer still remain, although it is questionable whether this is still relevant.
5. The company tax rate will fall to 28% for the 2011/12 year – so there is a bit of a delay there. This will also be the top rate for PIE's (from 1/10/10), unit trusts, superannuation funds and life insurance policies (the latter three from 1/04/11).

Just as there have been transitional rules covering the tax credits (imputation credits) attached to dividends from retained earnings taxed at

2010 Budget Summary

33%, there will be similar rules for profits earned in 2009 & 2010 that are taxed at 30%. There will probably be a window of 2 years through to 31/03/13 during which time the company can pay out dividends with imputation credits of 30% attached. After that date the level of imputation credits will be limited to 28%.

There is still a question over whether the company will have to pay RWT of an extra 3% or 5% on dividends paid out after 31/03/13.

6. QC's & LAQC's will cease to exist as we know them from 1 April 2011. The issue has been that losses have flowed through to individual shareholders who have been able to use them at a rate of 38 or 39%, while profits have been taxed at the lower company rate of 30%. To prevent that, all QC's & LAQC's will be flow-through entities, in effect turning them, for tax purposes, into something like the existing limited partnerships. All profits & losses will flow through to shareholders and be taxed at the shareholder's tax rate.

This raises some interesting questions about the ability to have salaries paid to shareholders- if they are now effectively partnerships then there is generally not the ability to pay a salary. So the ability to pay a salary to one shareholder who might be on a low salary, thereby increasing the level of loss that another shareholder who is on a higher income, may not be possible.

One concession is that there will be no tax cost to transition to the limited partnership lookalike provided that it is done by the first day of the 2011/12 income tax year. After that date, there may be issues with changes in ownership percentages giving rise to gains on sale.

Another interesting point about limited partnership lookalikes is that there may be de-facto ring-fencing of losses, given that the current limited partnership rules limit losses to the level of capital contributions by the partners.

It's probably fair to say that LAQC's as a means of holding rental properties may be doomed, but there will be more clarity around this in the days & weeks ahead. There may still be benefit in having QC's and being able to pass capital profits to shareholders without winding the company up.

7. GST will go up to 15% from 1 October 2010. There are already special transitional rules in the GST Act, but the areas to watch out for will be:
 - taxpayers on a payments or hybrid basis,

2010 Budget Summary

- where debit or credit notes are issued against supplies made pre 1/10/10,
- where bad debts are written off after 1/10/10 but the services were provided before 1/10/10
- where layby sales are not fully paid off by 1/10/10

8. The current 20% loading on all assets will disappear as of 20 May 2010.

Depreciation on buildings will reduce to 0% from the 2011/12 year (generally 1/04/11) where the buildings have an economic life (as determined by IRD) of more than 50 years and this applies to both commercial and residential properties, including leasehold property. Some buildings already have a life of less than 50 years – carparks, chemical works, site huts and other portable buildings – and depreciation will still be applicable in those cases.

At present buildings are the only depreciable asset where you cannot claim a loss on disposal if you dispose of it for less than book value. This has not changed, so even if you do realize a loss on sale of the property (presumably because it has depreciated in value), there will not be any deduction available.

The fitout of a building where it does not form part of the building can be depreciated. But on 31 March 2010, IRD did issue an interpretation statement IS 10/1 “Residential rental properties – Depreciation of items of depreciable property” which set out a three step test that IRD will apply to determine whether an item can be separated out or whether it is regarded as being part of the building. The commercial building fit-out policy to be reviewed and clarified (political speak for “will be tightened or go”) from 1 April 2011.

9. Rental and investment losses will now be excluded from income for the purposes of calculating social need allowances such as working for families, student allowances and rest home subsidies.

There will be a discussion document issued in August to determine whether income from trusts or PIE income (currently not required to included in a tax return) should also be included as income for calculation of those social need allowances. While PIE income should be relatively easy to work out even if administratively difficult to administer where the investments are through managed funds, the same cannot be said of trust income. There is about 500 years of trust law precedents that could be changed in a flash.

The good news is that there will be no change to the trust tax rate of 33%.

2010 Budget Summary

- 10 Land transactions will be zero-rated from 1 April 2011, but the zero-rating rules currently only apply where both parties are GST registered.

Presumably the second hand goods rules covering the purchase of land by a registered person from a non-registered person will also be changed to prevent a GST claim being made. This is a much simpler solution than the earlier proposed reverse charge regime.

This could result in some changes to the market values of newly developed properties, as developers (not that there are many about at the moment) will not be able to claim GST on the purchase of land, nor be required to pay GST on the sale but will be able to claim GST on the development cost.

There are also concessions made in relation to contributions received from developers for infrastructure costs on new developments, where the income can either be offset against the cost of putting in the new infrastructure or spread over 10 years.

- 11 The thin capitalization rules that currently apply to the debt financing of NZ subsidiaries of overseas companies has been increased from 75% (debt:assets ratio) to 60%. This is potentially a higher tax impost on investors in New Zealand.
12. And the very final sting in the tail- IRD will receive an additional \$120M over the next four years specifically for tax audits. The areas likely to attract the most tax audit interest are property transactions, the hidden (cash) economy, and GST "Phoenix" schemes. Tread with caution.

And our disclaimer: while every effort has been made to ensure the information contained in this brief summary is accurate, this brief outline is no substitute for specific advice on a specific situation. As always, the devil is in the detail, and you should not rely on this summary when making decisions on the tax position you wish to take.