

TAX CHANGES – 2010 BUDGET

The 2010 Budget held very few surprises as the Government had over the past 6 months leaked through a number of announcements some of the issues they were looking to implement. Some of the leaked announcements included other measures that were less favoured by the business community that perhaps helped sway the final changes in this budget thereby making them more acceptable.

This Budget is a 'give with one and take with the other' in that increases in the GST revenue and savings in the depreciation and investment tax measures will help to fund the drop in personal tax rates. As with any change to the tax system there will be winners and losers and while the Government have promoted this Budget as a stimulus for the economy and as the most significant change to the tax system in 25 years, only time will tell whether most people are better off.

While personal tax rates were cut slightly more than predicted the income thresholds have remained the same. The Government will need to watch that these thresholds are adjusted in the near future otherwise inflation will erode any tax savings.

PERSONAL TAX CUTS

These will take effect from 1 October 2010:

Income	2009/10	2010/11	2011/12
\$0-\$14,000	12.5%	11.5%	10.5%
\$14,001-\$48,000	21.0%	19.25%	17.5%
\$48,001-\$70,000	33.0%	31.5%	30.0%
\$70,000 and over	38.0%	35.5%	33.0%

As the rate changes take effect on 1 October 2010 the actual rates for the 2011 tax year will be half a year at the old rates and half a year at the new rates (see above).

Once we see the full impact of the top rate falling to 33%, it will then again be aligned with the Trust Tax Rate, which remains unchanged. This may reduce the use of Trusts as a mechanism to save tax, however there are still many valid reasons why you should still use a Trust ie creditor protection, rest home subsidies, assets for future generations, and possibly as a hedge against a future Government changing the rules.

The Government has signalled that the top tax rate may reduce to 30% at a later date but no timing was announced and will depend on how these cuts work and the state of the economy at that time.

RWT rates are to reduce in line with the new personal tax rates.

GST RATE INCREASE

Well the secret that everyone knew is finally out. The GST rate will increase from 12.5% to 15% and will take effect from 1 October 2010. GST is a tax that everyone has to pay and the Government has estimated this increase will net them an extra \$2.5 billion a year.

This extra revenue will be the main source with which other tax reductions will be funded.

ARE YOU READY TO COPE WITH THE GST RATE CHANGE?

1. Do your existing contracts allow you to increase the price charged to customers to cover the rate increases?
2. What changes do you need to make to your accounting and reporting systems?
3. Can your systems issue and receive tax invoices and credit/debit notes at both the "old" and "new" GST rates?
4. Can you maximise opportunities arising from any increased consumer activity in the lead up to the higher rate?
5. Are your GST compliance procedures accurate given the 20% increase in potential exposure a rate increase represents?
6. Will the GST rate increase affect your funding position or cost base?
7. Do you have to make a one off payments basis GST adjustment to allow for the change?

With there now only being four months to the new GST rate these issues need to be dealt with quickly. Already we are seeing large retailers advertising pre-GST increase sales for large ticket items to consumers who can not claim back GST. Expect to see more promotions, so don't miss the bus. Prepare and if you can take advantage of the situation to promote your goods and services before the increase, particularly to end user customers. There will however be increased competition and even perhaps a shortage of goods if consumers buy up just before 1 October. The last time GST increased we saw a flurry of buying leading up to the increase and a drop in the months after. However last time the economy was in a better financial position so history is not necessarily an indicator to what will happen this time around.

IRD TO GET MORE FUNDING

IRD will receive an extra \$119.3M over 4 years to assist it with audit, compliance and debt collection.

Cont..... Page 2

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COMPANY TAX RATE

The company tax rate will fall from 30% to 28% starting from 1 April 2011. While this drop on the face of it seems good, and does steal a march on the Aussies, our company tax rate will still be higher than the average OECD countries.

In addition with the top personal and trust tax rates being at 33%, for most New Zealand owned businesses the lowering of the Company Tax Rate is merely a timing issue to finally paying 33% when profits are withdrawn from the company as a dividend.

PORTFOLIO INVESTMENT ENTITIES (PIE's)

The top tax rate for PIE's, including KiwiSaver accounts, will be reduced from 30% to 28% effective from 1 October 2010. Other PIE rates will also reduce to align with new personal tax rates.

The Government seems keen to promote these types of investments which generally do not have to be declared in your tax return, the PIE pays tax on your behalf, and consequently the net return to you is "after tax".

The problems occur in choosing the correct tax rate to advise the PIE. These will vary from 10.5% to 28%. If you choose too higher rate you could end up paying too much tax with no way to recover it but if you choose a rate which is too low you will have to pay the shortfall. IRD wins again.

DEPRECIATION ON BUILDINGS

Some 3 months ago the Government announced that it was seriously looking at rental properties and in particular the use of LAQC's. A number of suggestions were released into the market, most of which were not acceptable, but the Government sowed a seed that changes were coming. Some of the suggestions were complex and costly, and finally the Government has decided to take a relatively easy path with little administration cost by axing depreciation on certain buildings.

Depreciation will no longer be tax deductible for both commercial and residential buildings with an estimated useful life of 50 years or more, starting from 1 April 2011. Depreciation will still be allowed for building fitouts. The depreciation already claimed to that date will remain on the books and adjusted when the building is finally disposed of.

DEPRECIATION ON NEW ASSETS

Businesses will no longer be able to claim the 20% accelerated depreciation rate on new assets as from 20 May 2010. The introduction of this accelerated depreciation was to encourage businesses to buy new assets rather than second hand and to also reflect the fact that new assets are inclined to depreciation considerably in the initial years of ownership. The Government are now saying that it is not the case and the same depreciation rate will apply regardless of whether the asset is new or second hand.

WORKING FOR FAMILIES

From 1 April 2011 families will no longer be able to deduct losses from investments (including rental properties) from their taxable incomes to qualify for "Working For Families Tax Credits".

Several years ago they closed one loop hole and prevented a loss from a rental property, owned by a LAQC reducing

income thereby allowing the shareholder to claim "Working For Families Tax Credits". However if the rental property was owned in your personal name the loss could still be deducted to reduce your taxable income and qualify for "Working For Families Tax Credits". Now that door has closed also.

Those in business using companies and trusts have been able to manipulate or shelter their income in order to qualify for "Working For Families Tax Credits" and the Government has now said that they will no longer allow that to happen. Adjustments will be required to an individual's income to add back losses and bring in income in other entities of which they control to calculate "Working For Families Tax Credits"

LAQC AND QC CHANGES

LAQC's (Loss Attributing Qualifying Company) and QC's (Qualifying Companies) will become flow-through entities for tax purposes. This means losses and profits will form part of the shareholders taxable income. Previously only the losses were mandatory attributed.

The IRD have for a long time stated that there are a growing number of tax payers using LAQC's in a way that was never intended. When the LAQC makes a loss, that loss is claimable by the individual shareholder sometimes benefiting by 38% in the \$.

When the LAQC makes a profit, that profit is left in the company which pays 30¢ in the \$.

This new change means all profits and losses will have to be shown in the individual's personal tax return effectively being treated as a partnership for tax purposes.

ZERO RATING OF LAND TRANSACTIONS

As from 1 April 2011 the transfer of land between two GST registered parties will be zero rated. There have been some cases where land was transferred between associated parties and the seller liquidated and unable to pay the GST on the sale while the buyer claims back the GST. This will assist future purchasers that won't have to finance the GST content on the purchase of land while they wait for the IRD process and refund their claim.

HOLD-UPS IN DONATION REBATES

From 1/4/10 the IRD were delaying sending out a donation refund until they had received the entity's tax return. However in recent days the IRD have reversed this policy change and are now releasing donation refunds before the tax return is filed using the 2009 taxable income as a guide for eligibility. Common sense does sometimes prevail.

HOW WILL THE BUDGET CHANGES AFFECT YOU?

Everyone will be affected in some way.

For businesses, the GST changes will probably appear daunting, but we have been through it before and we will work through the issues again.

We will be keeping you advised of the details as the legislation is passed on these changes and will run client seminars on the "old/new" GST rate implications nearer the change over date.

In the meantime if you have any queries or concerns please contact us by phone or email.