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NEWSLETTER BUDGET SPECIAL

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Inside this edition

Budget changes to income tax and GST etc

Changes in the GST rate, practical implications

Restructuring - the Three D's

Administration matters

This newsletter covers the recent budget changes and how it may affect you together with other business and legal matters.

We will be consulting with clients over the next few months to ensure that the changes work for you.

Should you have any queries in relation to matters discussed please do not hesitate to contact the team. John Weston



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2010 Budget

The 2010 budget was announced on the 20th of May and we have summarised the parts that may affect you.

GST rate increase

GST will be increased from 12.5% to 15% on the 1st of October 2010.

Personal Tax Rate Changes (to apply from 1st October 2010)

Income	Current	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%

So there are changes across all levels of income.

It is interesting to note that the average rate has fallen from 33% 18 months ago, to 17.5%, so we consider that the changes are real tax reform!

As in previous years however this is a change part way through a tax year. So for the 2011 tax year we will end up with transitional tax rates of six months at the old rate and six months at the new rate

These new rates will therefore only apply fully for the 2012 years onwards.

Increases in National Superannuation and benefits

To compensate low income earners and to allow for a GST rate rise (as detailed above) National super, main benefits, including Working for families tax credits, will be increased by 2.02% from 1st October 2010.

Company tax Rates, PIE investments

The company tax rate will fall from 30% to 28% from the 1st April 2011.

The tax rate for PIE investments will also fall from 1st April 2011.

So for any clients with this type of investment you should be adjusted to this new rate if you are currently on the rate of 30% for the investment.

Changes to depreciation rules and property investors

From 1st April 2011 depreciation on buildings will effectively be scrapped unless you can show that the building has a useful life of less than 50 years (the depreciation rate is being changed to a rate of zero).

This will have a dramatic effect on clients who have residential or commercial rental properties. The taxable income of the investment property will increase in the 2012 tax year.

This will mean that any depreciation claimed to date will be parked and calculations of possible depreciation recovery will only be calculated when the property is sold.

For commercial properties there is to be a rewrite of the legislation covering building fit outs and the depreciation that can still be claimed on this part of the building.

LAQC Companies

The new regime to be developed between now and 1st April 2011 will be to change LAQC companies to have the similar restrictions as to what are called "Limited Partnerships".

This is a major change and for these types of Companies it will remove dividends, imputation credits etc.

The loss able to be claimed will be limited to what was originally invested and the share of any debt guaranteed by the shareholder and also some other restrictions.

Any profits made by the company would be taxed at the marginal tax rate of the shareholder.

It is however early days and we may need to consider whether an LAQC company is the right structure (for some clients) moving forward, depending on the final result of the changes proposed.

Many of our clients happen to be set up as LAQC companies for their trading activities (not property).

The above changes may also affect you so we will have to review your company's status as an LAQC for the future between now and the 1st of April next year.

Provisional tax

Due to the lowering of the tax rates for individuals the uplift will change to 95% instead of 105% that is currently calculated.

For those clients that your 2010 Tax Return has already been completed by us there will be a change in the amount of provisional tax that you will have to pay in the coming year.

Redundancy Tax Credit

The current 6% redundancy tax credit for individuals (designed to help people put into a higher tax bracket as the result of a redundancy payment) will be removed from the 1st of October 2010.

So if there is a chance that you will be made redundant it would pay to have the payment made before 1st October 2010.

GST and Land Transactions

From 1st April 2011 transactions involving the transfer of land between registered clients will be zero rated for GST purposes.

Working for Families Tax Credits

People will no longer be able to use investment losses, including rental losses to reduce their income to be eligible for family support.

Increased IRD audit Activity

To better ensure the "integrity" of the tax system the Inland Revenue Department will receive a funding boost of \$119.3 million over 4 years.

The funding will increase the Departments audit and compliance activity around debt collection, the hidden economy and property transactions.

So expect more audits, justified or not, in the future.

Does the new package help the average taxpayer?

Do the above changes help the economy and is this just a package for high income people.

We believe that the package will be good for New Zealand and based on the following table (from IRD) the overall impact will be an improvement for clients on the various tax bands (on average).

Less than \$40,000	
Personal tax	0.9% saving
GST	-2.5% extra
Income support	2.6% extra
Other measures in budget	-0.03% worse
Net impact	0.7% better off

\$40,000 to \$85,000	
Personal tax	2.8% saving
GST	-2.5% extra
Income support	0.6% extra
Other measures in budget	-0.5%
Net impact	0.4% better off

\$85,000 an over	
Personal tax	4.2% saving
GST	-2.5% extra
Income support	0.1% extra
Other measures in budget	-1.0%
Net impact	0.7% better off

Changes in the GST rate - practical implications

While the change to the GST rate seems simple there are some practical issues to consider.

Contracts

What rate of GST will apply to contracts that are conditional and unconditional on the date that the GST rate changes?

What happens if there is a fixed rate contract at 12.5% rate but it doesn't settle until after the 1st of October.

Do I have to pay the extra tax and can I recover it from the other party?

Whether time of supply has been triggered becomes a crucial consideration, especially for big ticket items or large adjustments such as a change in use or GST de-registration.

In the case of real estate contracts where the GST content can be significant the contracts will require close scrutiny.

The GST Act has transitional provisions in section 78 to deal with the rise in the GST rate. In a nutshell it states that the vendor can increase the purchase price and recover the additional GST where the contract has been entered into within 3 months of the rate change.

Case law has also held that where a contract is "GST inclusive" the clients have contemplated the rate increase.

Calculation of GST

How do I calculate the new GST content on an item? Well the formula to use is 3/23.

Here is an example:

Cost of goods is \$1000 – what is the GST content

$$\$1000 \times \frac{3}{23} = \$130.43$$

Or another example

Cost of goods is \$1150 – what is the GST content

$$\$1150 \times \frac{3}{23} = \$150.00$$

If you are adding GST onto an item just multiply by 1.15 or times by 1.15.

Aligning GST periods

For those clients that we complete GST returns for and their GST period straddles the 1st of October 2010 we will be changing the GST period so that it ends in September, otherwise two GST returns will have to be completed - one to the 30th of September and the other to the 3rd of October.

Cessation of business or change of use

The GST rate change is relevant to those of you who are looking at leaving the GST net (a change in use or de-registration).

If you have assets that are no longer to be used in the business, or you are ceasing your activity any retained assets will attract GST at the higher rate.

So you would be better to cease before the 1st of October 2010.

Purchasing second-hand goods

This has particular relevance to our property developer clients. Second-hand goods are generally items that are purchased from parties who are not GST registered.

The GST would be able to be claimed at a higher value if the purchase was deferred to after 1st October 2010.

For example a purchase of land at \$100,000 at the old rate would give a GST refund of \$11,111, but after the GST change you would obtain a GST refund of \$13,043.

Accounting for GST in October.

Care will have to be taken whether you are registered for GST on a payments basis or invoice basis.

If you are registered on a payments basis for GST you will have to note the items that are banked in the transition period that may have different rates of GST attached. This may lead to a more manual processing of your GST returns.

For clients on an invoice basis again care will have to again be taken that invoices are correctly matched to payments when received to avoid errors or confusion.

Restructuring - The three D,s

With the economic downturn still happening, interest rates likely to rise and changes to tax breaks many of our clients may be considering downsizing debt reduction or disposing of property

Downsizing

- If the company is held by a Trust or a company then the sale needs to be in the best interest of the company or the beneficiaries of the Trust

- There may be depreciation recovery on the sale that is subject to income tax.

- Valuations may be required if clients are not dealing at "arms length" to avoid gifting issues

- If the sale involves the sale of shares in a company, rather than the sale of the property there are minimum continuity of shareholding issues to consider with regards to tax losses and imputation credits.

Debt Reduction

- The cost of breaking fixed interest rate repayments may be significant.

- The lender may require all sale funds to be taken off existing loans. You may then not meet bank lending criteria for the balance of the existing loans under tougher recessionary banking requirements.

Dispositions

- For commercial properties you need to consider whether GST is payable on the transaction.

- The associated party rules affect dealers and developers that impact on gains that otherwise may be tax free

- Commercial tenants may be looking to change premises to not only reduce costs but as a result of lease inducement and incentives (such as rent free periods). The tax treatment for each party will depend on how the deal is structured and the tax profile of each party.

- Often in fixing one problem you may create another. For example the transfer of a leaky home to a trust or company. Whilst this may have estate planning benefits it will prejudice any claim the Trust or company has in relation the leaky home.

Acquiring the home with knowledge of a leak may also amount to negligence.

Administration matters

Tax payment years

Many clients are paying their tax online which is a clean and efficient method of paying.

However please ensure that you use the correct tax year as the tax payments dates have changed.

A common mistake is to make the payment due on the 7th of May (third instalment of provisional tax) as payment for the coming year's taxes. For example please note that the payment that was due on the 7th of May 2010 was for the 2010 tax year, not the 2011.

For clients that consistently pay their taxes in the wrong year and we have to complete transfers on your behalf we will charge an administration fee.

Paying tax arrears over a period of time

We have clients who are paying their taxes over a period of time of up to 12 months per an instalment arrangement organized with the Inland Revenue Department.

Alternatively the taxes are just not paid on time.

In these instances we will not always send a statement when it is received each month.

For clients who do not pay the taxes and we have to keep reminding them we will also charge an administration fee in the future.