



TAX CUTS!

1 October 2008 saw the introduction of the Labour Government's program of personal tax cuts to individuals.

In addition the National Government have proposed further tax cuts at 1 April 2009.

The table below shows a comparison of the current rates and the new rates applicable:

NEW RATES

Old rates (including rebate)

From 1/10/2008 Labour

From 1/4/2009 National

15%* to \$9,500	12.5% to \$14,000	12.5% to \$14,000
21% to \$38,000	21% to \$40,000	21% to \$48,000
33% to \$60,000	33% to \$70,000	33% to \$70,000
39% over \$60,000	39% over \$70,000	38% over \$70,000

* including the low income rebate.

The low income rebate which used to apply to reduce a 19.5% rate to 15% did not apply to passive income such as dividends and interest. This has been abolished and all income is now eligible for the lowest rate of 12.5% on the first \$14,000.

For the 2008 / 2009 year, a "composite" set of rates has been introduced that recognises six months at the old rates and six months at the new rates. There is no need to do part year accounts, or tax various items at different rates according to when they are derived.

Wage and salary earners will benefit from the first pay period ending on or after 1 October 2008 as the tax cuts result in lower PAYE deductions made.

Provisional taxpayers also see a reduction in provisional tax payable on instalments after 1 October if this is calculated on an "uplift" basis.

As a result in the change in personal tax rates, there are also changes to the FBT multi rates meaning there now is a seven rate calculation for the 2008/2009 income year. Also there are changes to the rates and thresholds of

Employer Superannuation Contribution Tax ("ESCT") for employer contributions made after 1 October.

Tax Changes Coming your Way

July last year saw the introduction of a major tax bill containing a number of important changes. Although this bill has not yet been passed, it is expected that the legislation will be enacted early in the term of the new Government. With some changes expected to have an implementation date of 1 April 2009 (although this may be extended to 2010 in some cases), there will be limited opportunity to get up to speed with the details before they take effect.

Therefore we outline here some of the more significant proposals, and how they may affect you.

We note the National Government has also introduced a further December 2008 Tax Bill introducing their tax cuts package and possibly other changes. If these other changes are significant we will issue a further Tax Brief in the near future.

Payroll Giving

New rules allowing taxpayers to obtain a real time benefit from charitable donations will be introduced by way of a system of payroll giving. Administered through the PAYE system the payroll giving rules will allow employees to get the benefit of the tax rebate on qualifying donations, at the time the donation is made.

Payroll giving will be optional for both employers and employees. It will work by providing a PAYE credit of 33.5% percent on employee donations, meaning this method delivers the same benefit of the current annual

rebate system. The PAYE credit reduces the amount of PAYE deducted by the employer from an employee's gross pay.

While the payroll giving process may impose an additional administrative burden on the employer, we see it as likely to be favoured by employers who have a special relationship with one or more approved charities and want to encourage their employees to take part in that relationship. Note: It is the employer's responsibility to ensure that the recipient of the donation meets the charitable criteria.

Example:

Edward Employee receives \$350 gross per week in wages and makes regular donations of \$20 per pay. Edward is on a 19.5% tax rate.

Weekly gross pay	\$350.00
Less payroll donation	\$20.00
Employee's (donor) residual weekly pay	\$330.00
Less PAYE on \$350	\$64.35
Tax credit @ 33.33% (20 x 33.33%)	\$6.67
Employee's Net Pay (350 – 20 – 64.35 + 6.67)	\$272.32
Charity receives	\$20.00
Inland Revenue receives	\$57.68

Relocation Payments and Overtime Meal Allowances

Do you pay staff extra when they work late? Or contribute to the costs when they move town?

Changes are being made to tax legislation to ensure (a previous amendment potentially meant these payments were taxable) that payments made by employers when relocating employees, and provision of overtime meal allowances are exempt from income tax and fringe benefit tax if certain criteria are met. The amendments apply retrospectively to payments from the 2002 / 2003 income year and onwards.

Relocation payments may be deductible to the employer and non-taxable to the employee where they relate to:

- Taking up a new employment
- Taking up a new position for an existing employer
- Continuing the same employment at a new location

In order to be treated as tax-free payments the following criteria must be met:

- The payment must be of the types set out on an IRD schedule;
- The amount paid is not more than the actual eligible relocation expenses that the employee incurs;
- The expenses must be incurred within the period starting from the income year in which the employee relocates to the end of the next income year; and
- The employee's existing residence must not be within reasonable daily travelling distance from the new workplace.

New legislation provides that an amount that an employer pays to an employee for a meal when the employee is working overtime is exempt from tax where the following criteria are met.

- The employee's employment agreement must provide for pay for overtime hours worked; or the employer must have an established policy or practice of paying for overtime meals. (This is intended to cover situations when salaried staff are required to work overtime during periods of particular work pressure); and
- The overtime meal payment must only cover either the actual expenses or a reasonable estimate of those expenses.
- "Overtime" is defined as the time worked on the day beyond the person's ordinary hours of work as set out in the employment agreement when the employee has worked more than two hours beyond his or her ordinary hours on that day.

Raising Certain Tax Thresholds

The Budget announcements in May 2008 regarding changes to certain tax thresholds form part of the July 2008 Tax Bill. These changes are set to apply from 1 April 2009. The proposed changes are set out here:

- Raising the threshold for filing and paying PAYE once a month from \$100,000 to \$250,000 in total annual PAYE and ESCT (employer superannuation contribution tax) deductions.
- Raising the threshold for filing annual FBT returns (rather than quarterly) from \$100,000 to \$250,000 in annual PAYE and ESCT deductions.

- The safe harbour threshold before individuals pay use-of-money-interest on provisional tax is being increased from \$35,000 to \$50,000 (residual income tax).
- The exemption for low-value trading stock is being raised from \$5,000 to \$10,000 (based on value of trading stock).
- Non-individuals, such as companies and trusts will be allowed to return income tax for financial arrangements on a cash accounting basis. The current thresholds for the individuals' cash basis will now apply to these types of non-individuals.
- The threshold for allowing financial arrangements to be accounted for on a straight-line basis will increase from \$1.5 million to \$1.85 million.
- The turnover threshold for GST registration is being increased from \$40,000 to \$50,000.
- The threshold for filing GST on a six-monthly basis is being increased from \$250,000 to \$500,000 (based on annual turnover).

Exemptions for Offshore Income

In what is a fairly bold and significant step it is proposed to change the way we tax offshore companies owned by New Zealanders. This change is considered necessary to ensure that as companies expand offshore the New Zealand tax system does not provide an incentive to shift all operations outside New Zealand.

Accordingly, new exemptions will apply to exempt from tax certain income arising from Controlled Foreign Companies (CFC's).

A CFC is a foreign company that is:

- Owned 50% or more by five or fewer New Zealand resident shareholders; or
- Where a single New Zealand resident controls at least 40% of the company and there is no single non-resident shareholder controlling 40% or more of the company.

Under the existing rules, the CFC's income is attributed to its New Zealand resident shareholders, in proportion to their interest, and is therefore taxed in New Zealand. This is regardless of whether the income is actually distributed by the CFC to its shareholders or retained in the foreign entity.

Under the proposed changes, CFC income will no longer be taxed in New Zealand where it is active business income of the foreign company. If a CFC has less than 5% "passive income" its income no longer needs to be attributed at all to New Zealand resident shareholders. Passive income is defined to include dividends, financial arrangement income and interest, royalties, rents, income from personal services, and various other specific items.

If a CFC derives more than 5% of its income from "passive" sources apportionment is required to ensure that the New Zealand resident shareholder is taxed only on the passive income of that offshore company. The passive income will be calculated and attributed to the New Zealand shareholder in proportion to their interest in the underlying company. This attributed amount will be taxable.

The "grey list" exemption previously meant investments in certain countries did not have to be attributed to New Zealand resident shareholders under the CFC rules. This

applied to Australia, Canada, Germany, Japan, UK, USA, Norway and Spain. This grey list has been abolished, meaning the new rules will apply to tax passive income arising in these countries, with an exception remaining for companies resident in Australia.

Foreign dividends paid by CFC's will also be exempt from income tax to New Zealand companies unless they are tax deductible to the payer, or are fixed-rate dividends. Any requirement to deduct Foreign Dividend withholding payment, or to maintain Branch Equivalent tax accounts will be removed.

Limited Partnerships Act 2008

The Limited Partnerships Act 2008 came into force on 2 May 2008. This Act creates a new form of partnership (limited partnership) which over time will replace special partnerships. It is expected that Limited Partnerships will be a favoured structure to allow foreign capital to be invested in New Zealand ventures.

Key features:

- Each partnership has General partners and Limited partners.
- A Limited partnership provides limited liability to the limited partners and has some limited liability benefits of a company while still being a flow through entity for tax purposes.
- Limited partnership is required to be registered and have "Limited Partnership" or "LP" at the end of its name.
- It must have a partnership agreement. The limited partnership is a separate legal person.
- Investing partners have limited liability while working (general) partners do not.
- General partners are jointly and severally liable for debts and liabilities of the Limited Partnership.
- A Limited Partner is not permitted to take part in the management of the Limited Partnership and will not be liable for the debts of the partnership.
- A Limited Partner's losses are limited to their capital invested.

Taxation (Limited Partnership) Act 2008

The Taxation (Limited Partnership) Act 2008 came into force on 1 April 2008 in conjunction with the Limited Partnerships Act 2008. It contains some key changes that apply to all partnerships. These will particularly impact on situations where there is a change in the partners of a partnership.

Key features:

- A partner is treated as carrying on the activity of the partnership and having the intention and purpose of the partnership.
- A partner is treated as holding property that the Partnership holds.
- Provided certain thresholds are not exceeded a new partner entering the partnership is treated as "stepping into the shoes" of the exiting partners, and therefore assumes their existing book values. No adjustments are required in the accounts of the partnership to recognise that change in partners.

- On the final dissolution of a partnership the partnership is treated as disposing all of the partner's interest to a single third party, at market value. All gains or losses are crystallised at that point.

GST Discussion Document

Inland Revenue issued an Issues paper in mid June 2008 entitled "Options for strengthening GST neutrality in business-to-business transactions."

This fairly major review of the GST rules is likely to signal a number of significant changes in the not too distant future. However, the document is not particularly clear about what form those changes may take. Rather it is seeking feedback on particular areas of concern.

- This document suggests and discusses a number of options to solve the problems that can arise in connection with the supply of significant assets, and to improve the operation of the Goods and Services Tax Act 1985 for businesses and the Government. As part of this, the document has suggested measures to help ensure business neutrality and reduce base maintenance risks associated with GST.
- Managing the Government's revenue risk is also a focus:

The Discussion Document considers introducing the following:

- Enforcing business-to-business neutrality;
- Widening the current set-off powers;
- Power to impose caveats;
- Extending the timeframe for the release of refunds to 20 working days.
- Limiting the choice of accounting bases (make one compulsory); and
- Strengthening the application of existing anti-avoidance measures
- Increase in the payments basis threshold.

- The Government still has concerns around the change-in-use rules. The proposals include consideration that:

- Adjustments made on a period-by-period basis will not be more than the original GST paid on the purchase of the property;
- The current change-in-use adjustment approach may ignore the original input tax deduction claimed by the GST registered person;
- The treatment of adjustments on return to the original taxable purpose means that taxpayers claim back any output tax adjustments that they had paid. This is inconsistent with the adjustment framework.

- Accommodation

Two options are being considered. These include:

- changing the definition of "dwelling" so it is defined by reference to the residential use of the accommodation, and change the definition of "commercial dwelling"; or
- replacing the current legislative framework with terms that are more descriptive of the normal use of the business, for example changing the term "commercial dwelling" to "guest accommodation" and introducing terms such as "care accommodation" and "residential accommodation".

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