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Newsletter

May 2010

Budget 2010 – our comments

There are always some surprises with the Budget announcements, and this was no exception. We advise herewith the bad aspects first, before the favourable ones – and there are a number of important aspects which have not been announced in the budget but which we interpret will create a definite tax cost for our clients, particularly those operating through a LAQC. More on this in detail at the rear of this newsletter.

It appears a clever, well thought out budget, with concessions for all taxpayers – but there are hidden aspects which will prove to be particularly costly. The costly aspects (bad) were:

GST increase by 2.5% to 15% - as expected from 1 October 2010. To extract the GST content from that date – divide by 7.67 – not 9, or $^{3}/_{23}$.

No depreciation claim available on buildings with a 50 year life – these will include all commercial buildings, particularly those built of concrete and steel, and all houses, and some farm buildings – woolsheds, hay barns if built of substantial long term materials.

We expect that all milking sheds will be excluded and there will be more detail to come on how to interpret a building without a 50 year life.

The depreciation claim was originally 3% - and now 0 as from 1 April 2011. This will create added annual tax increase by property owners, but existing buildings will still have accumulated depreciation at 1/4/2011 – which we will need to separately record for a future taxable depreciation recovery if and when they are sold.

Plant and machinery depreciation – the 20% loading on depreciation of new assets to be removed immediately from 20th May 2010.
ie 14.4% to 12%
24% to 20%

LAQCs
From 1 April 2011 legislation to be introduced after a consultation process that will required LAQCs to be taxed as if they were limited partnerships, or ordinary partnerships. See the detail later on the tax effect.

Thin Capitalisation Rules – effective for overseas owned businesses. The “Safe Harbour” limit for gearing on these foreign owned investments is to be reduced from 75% to 60% from 1 April 2011 – taxed at 5%, requiring more equity to be paid into NZ to avoid this special tax, and reduced borrowings.

Inland Revenue Department Audits - $26.6 million extra to be available over four years for the IRD for tax audits, especially for property developers and owners – an increase of $12 million

In the last three years, IRD had $14.6 million for tax audits, which produced a 5 x increase in tax revenue.

Thus there is trouble coming for sure, and your tax agent, working for you, advice will be even more important from 1/4/11.

Working for Families – combined incomes – cannot claim rental or investment losses to calculate these – thus a reduction in entitlement from 1.10.10, this and NZ Superannuation, and benefit payments will increase.

Redundancy Rebate – to be removed as from 1/10/10. Was a maximum of $3,600, or 6% of redundancy payment back to 1/12/06. Back claims still available.

Beneficial Budget Comments (good)

Reduced personal tax rates effective from 1/10/10.

	New rate	Old rate
$0 - $14,000	10.5	12.5
$14,001 - $48,000	17.5	21
$48,001 - $70,00	30	33
$70,001 +	33	38
Companies – from 1/4/11	28	30
Trusts (same)	33	33

This is the lowest company tax rate since 1989, and is 2% less than Australia.

As well, for property owners – we have
No land tax
No capital gains tax

We have escaped two nasty changes which were discussed pre-budget.

Ring Fencing of Tax Losses – property losses could only have been carried forward and claimed against property income.

Deemed Rate of Return Tax – taxable at rental yield of say 6% - even though with the interest cost the property still makes a loss.

The reduction in the personal tax rate above $70,000 of 5%, will change how we allocate income from a company or a trust to individuals – and in some cases property owned by individuals will now be able to be transferred even though there is a tax cost with depreciation recovery, more effective tax vehicles, ie a company with a lower tax liability.

What the Budget did not explain, which we have analysed

Dividend Tax Credits – the rate will stay at 33%. With reduction in company tax rates to 28% from 1/4/11 (now 30%) at present, when we declare dividends to the shareholders, either personal or in many cases family trusts, an additional 3% in cash is paid, and 30% from the imputation credits (previous taxes paid by the company).

The shareholder receives a dividend with a 33% tax credit – and thus trust shareholders receive their dividends tax free.

Once the 28% rate applies for the year ended 31/3/12, imputation credits will be accumulated at 28% and then dividends are declared, 5% in cash will need to be paid when the dividends are paid – as the Dividend Tax Credits rate remains at 33%.

There will be an incentive to retain income in the company at 28% and achieve the lowest possible tax rate by doing so, and this is likely to have an effect on dividend payments.

LAQCs (Loss Attributing Qualifying Companies)
At present, losses made by these companies which usually own property and are claiming high interest and depreciation the loss is claimed, when the shareholders are under five, directly to the shareholders – thus we advise that the shareholder with the highest personal income has the highest shareholding. The mortgage finance debt servicing is assisted by the annual tax refunds received by the shareholders personally from claiming these annual losses.

The IRD has longed to change these very tax effective vehicles, particularly with a change in the company rate, compared to the personal rate and they now have the opportunity as provided in this budget from 1 April 2011. The Budget stated that from 1/4/2011 (subject to legislation yet to be passed) the loss can be claimed by the shareholder, but only at the company rate which will be 28% - vs 33% for the individual above $70,000 of income,

Thus we will need to make a special calculation when we file individual tax returns where there are losses from LAQC. Treasury has already released an Official Issues paper entitled “Qualifying Companies – Implementation of Flow Through Tax Treatment”. Submissions are now being called on these changes. There is no doubt that these changes are going to have a significant impact on LAQCs and whether they will continue to be used for property investment or not – we expect a restructuring of ownership for a percentage, almost immediately, particularly with high gearing in place, and where the ordinary partnership structure is more beneficial.

Rather than allowing and encouraging LAQCs, the view has now been totally changed that being able to reduce personal tax by 33% by an LAQC loss, and when an LAQC profit is retained in the company and then only taxed at 28%, will lead to tax avoidance. Thus the flow through tax treatment discussion – which means that profits from LAQCs will be taxed in the shareholders’ own hands at their own personal tax rate – not at the company rate of 28%.

This creates additional tax liability by stealth, for to change from LAQC to an ordinary or limited partnership will require a “sale” at market value of the property – and hence an immediate taxable depreciation recovery which can be very major if the building has been owned long term and depreciated annually at 2 – 3% on cost.

However, some property owners will make the change regardless, and Inland Revenue Department will happily tax them on the depreciation recovered – even though they effectively continue to be the owner of the building.

There are further potential problems for LAQCs when shareholders dispose of their shares or cease to meet the qualifying criteria for LAQCs – under the new rules the share transfer is treated as disposing of the share in the property company and would bear a tax liability associated with this share sale – once again due to the flow through of tax treatments applying.

At present shares in an LAQC can be disposed of readily amongst shareholders with no tax liability resulting.

If these changes do all take place, there will be a considerable added compliance cost and that includes accounting costs, to comply with these new rules.

As each client's affairs are different, we will be in a position to advise you what is the best structure to own rental properties once the legislation has been confirmed.

If you do operate through an LAQC, we encourage you to read the officials' issues paper of these changes – at the following link

http://www.taxpolicy.ird.govt.nz/sites/default/files/2010-ip-budget2010-laqcs.pdf

Provisional Tax

When we calculate your 2010 taxable income and tax payable, we have the opportunity to reduce the 2011 provisional tax to 95% of 2010 – which will certainly be an immediate help.

There has been no proposed changed to the depreciation rate on residential chattels which have generous depreciation rates – but legislation has already been passed that internal fixtures which we could previously depreciate separately, must now be at the house or building rate – a maximum of 3%. This removes electrical wiring, fixtures, suspended ceilings, plumbing, all to the 3% rate – and furniture must be loose, not fixed, before the higher rates still apply.

This newsletter is a service to our clients, and enables you to keep up to date with the latest tax changes.

Please feel free to pass it onto friends or other businesses, for we are always ready to accept additional clients.

The Withers & Co partners and staff team are ready and willing to assist you with all accounting and taxation matters.

Withers & Co Ltd
24 May 2010