

OTAGO PROPERTY INVESTORS ASSOCIATION MEETING JUNE 2010

Scott Findlay, director of Findlay & Co Chartered Accountants Ltd spoke in depth on the tax changes resulting from the May 2010 Budget

Company and personal tax changes

The new tax rates will apply to income earned by individuals from 1 October 2010.

The bottom tax rate will be lowered from 12.5% to 10.5%, the 21% rate to 17.5%, the 33% rate to 30%, and the highest rate lowered from 38% to 33%.

Consequential changes to other aspects of the tax legislation – such as PAYE tax and provisional tax, resident withholding tax rates for interest income, portfolio investment entity tax rates, and fringe benefit tax – will be made to coincide with these changes.

	<i>Old tax rates applying to PAYE for the period 1 April 2010 – 30 Sept 2010</i>	<i>New tax rates applying to PAYE for the period 1 Oct 2010 – 31 March 2011</i>	<i>Composite tax rates for 2010–11 income year</i>
\$0 – \$14,000	12.5%	10.5%	11.5%
\$14,001 – \$48,000	21%	17.5%	19.25%
\$48,001 – \$70,000	33%	30%	31.5%
\$70,001 and over	38%	33%	35.5%

GST rate increase

The rate of goods and services tax (GST) is being increased to 15% from 1 October 2010, as part of a switch in the tax mix from income tax to consumption tax. The GST rate was last increased in 1989. Under the proposed rate change, businesses and organisations registered for GST will be required to account for GST at the new rate of 15% from 1 October 2010. The rate of increase will also apply to goods imported on or after 1 October 2010. The new tax fraction will be 3/23. This fraction can be applied to the price of goods or services to see how much GST is included in the price. For example, if the cost of a Television is \$2,000 inclusive of GST, the GST included in the price will be \$260.87 $(\$2,000 \times 3)/23$

Businesses will need to alter their systems to incorporate the new rate. They may also alter the prices they charge for the goods and services they supply to cover the increased GST liability. This may not only impact on businesses' current stocks or transactions but also on their forward orders or deferred supplies and existing contracts.

Depreciation

The bill changes the depreciation rate of buildings with long estimated useful lives to 0%, and removes depreciation loading on items purchased after 20 May 2010. The bill sets a 0% depreciation rate for buildings with an estimated useful life of 50 years or more. This new rate

will apply to all such buildings regardless of when they were purchased. The depreciation rate for these buildings will be set to 0%, the depreciation rate for items used in, but not part of, these buildings remains unchanged, and they will be able to continue to be depreciated separately from the building itself. The incentive to encourage New Zealand businesses to invest in new capital equipment has also been removed. This means the 20% loading on new assets is removed from items purchased after 20 May 2010.

The proposed changes will not affect the deductibility of repairs and maintenance. While this can be a complicated matter, with the correct treatment often being a question of both fact and degree, some general guidance is set out below.

There is a two-stage approach to determine whether certain expenditure is deductible:

1. Identify the relevant asset – that is, is the item being repaired/replaced part of a larger asset (such as the roof of a house), or is it a single asset (for example, a television)?
2. Ascertain the nature, extent and cost of the work undertaken. This will involve determining whether the work remedied wear and tear (generally deductible), or whether the asset has been improved or otherwise substantially changed (generally non-deductible).

LAQC/QC Changes

There are some radical changes proposed to the LAQC/QC regime. The main changes are as follows:

The distinction between a qualifying company (QC) and an LAQC will be removed.

There will be only QCs that will be allowed only one class of share. QCs will be taxed similarly to a limited partnership, not a company, with the income and losses flowing through to shareholders in a QC in proportion to their "effective interest" (generally a shareholder's voting interest).

A loss limitation rule will be imposed. Losses will be able to be claimed by a shareholder in a QC but the amount will be limited to the value of that person's investment in the QC. Excess losses may be carried forward and utilised when the shareholder's investment in the company increases.

Amounts derived from the QC will retain their character in the shareholder's hands; that is, capital distributions will be treated as a capital receipt by the shareholder and revenue distributions will be treated as income.

Shareholders in a QC will no longer be personally liable for the company's income tax when electing to become a QC.

A shareholder will be required to account for tax on disposing of their interest in a QC only if the value of the proceeds from the disposal exceeds the total net tax book value of their share of company property by more than \$50,000. The same exceptions to this rule that apply to partnerships will also apply to shareholders in a QC.

There will be a deemed disposition and reacquisition at market value of the company's assets when the company ceases to be a QC. The shareholder will therefore be required to account for tax on the disposal of their share of the QC's property.

On liquidation of a QC a shareholder of a QC will be treated as having disposed of and reacquired all of their interest in the company at market value.

The QC will be required to file an IR 7 partnership income tax return.

There will be no tax costs associated with an existing QC transitioning into the new QC rules.

Working for Families

The income threshold at which WFF tax credits begin to abate will be set at the current threshold of \$36,827 and will take effect on 20 May 2010.

Investment losses will be excluded from the calculation of family scheme income for WFF tax credit purposes. This means that if a person has an investment in an income year, such as a rental property, and that investment produces a net loss, the income and deductions from that investment will be ignored for calculating income for WFF tax credit purposes. This will take effect on 1 April 2011.