

black & white paper

Budget 2010 – Tax implications

The Government's Budget 2010 included a number of changes to our tax system. This Black & White Paper outlines some of the key changes and how they will affect public entities and the audits we carry out for those entities.

The key changes

The key tax changes that were announced in the Budget are:

- All personal income tax rates will be cut from 1 October 2010, as follows:
 - Income up to \$14,000 will be taxed at 10.5%, down from 12.5%.
 - Income from \$14,001 to \$48,000 drops to 17.5% from 21%
 - Income from \$48,001-\$70,000 down to 30% from 33%
 - Income over \$70,000 will be cut to 33% from 38%.
- GST will increase from 12.5% to 15% from 1 October 2010. Income support and other payments will rise by 2.02% to compensate for the increase. This includes student allowances and supplementary benefits, superannuation, veteran's pension and the Working for Families tax credit.
- The company tax rate will be reduced from 30% to 28% from the 2011/12 income

year. For tax purposes, a company includes local authorities, licensing trusts and incorporated societies.

- The top tax rate for people saving through portfolio investment entities (PIEs) and other managed funds, including KiwiSaver, will be reduced from 30% to 28%.
- Buildings with an estimated useful life of 50 years or more, such as rental housing and office buildings, will have an annual depreciation rate of 0% for tax purposes. This change applies from the 2011/12 income year. Tax depreciation deductions that have previously been claimed by building owners will generally be treated as taxable income when the building is sold.
- The current 20% depreciation loading on new plant and equipment will be removed for assets bought after 20 May 2010.
- Entities receiving capital contributions to construct assets, such as energy companies, will be required to either treat the contribution as taxable income, spread over 10 years, or alternatively

reduce the tax value of the asset by the amount of the contribution. These changes apply to capital contributions derived after 20 May 2010.

What the Government didn't do

There were a number of recommendations from the Tax Working Group that were not adopted by the Government. The Government decided not to introduce a capital gains tax or a land tax. The Government also decided not to introduce a deemed rate of return for rental properties or a ring fencing of rental losses (i.e. only allowing the losses to be offset against future rental income).

Another change that was being considered by the Government was a bright line test for property sales (i.e. taxing gains on sale within say 3 years of acquisition). This was also not introduced.

The Government has not yet managed to align personal, trust and company tax rates. However, the top tax rate for individuals has now been aligned with the tax rate for trusts.

Implications of the drop in personal tax rates

Due to the drop in the top tax rate for individuals, the rate of FBT will drop to 49% from the quarter ended 31 December 2010. The alternate rate (or multi-rate) calculation will still be available, but composite rates will be required for the 2010/11 year.

The rates of RWT on interest income will be aligned to the new personal tax rates.

Fund withdrawal tax will cease to apply to withdrawals from superannuation funds, provided the withdrawal relates to employer's contributions made on or after 1 October 2010.

The redundancy tax credit will be repealed from 1 October 2010.

Implications of GST rate increase

The tax fraction for GST at 12.5% is 1/9. The tax fraction at 15% is 3/23. Among other things, the tax fraction is used to calculate the adjustment for GST on fringe benefits and to calculate the second hand goods input tax credit on property acquired from non-registered persons.

The GST rate applicable to long-term accommodation in commercial dwellings, such as hostels and rest homes, will

increase from 7.5% to 9%. Any composite rates used by entities providing this type of accommodation (e.g. Hospitals, TElS) will also need to be increased.

Most accounting systems will need to be modified to accommodate both the old and new rates of GST. In general, invoices issued on or after 1 October 2010 should use the new GST rate. However, in some cases, time of supply may have been triggered by an earlier payment. Credit notes, debit notes and bad debts adjustments relating to invoices issued prior to 1 October 2010 should use the old GST rate, rather than the new rate. For several months after the change in rates, invoice batches processed through the creditors system may include a mixture of invoices at the old and new GST rates. GST input tax deductions should be based on the amount specified on the invoices.

Impact on rates charged by local authorities

As some of you will be aware, SOLGM has been relatively busy over the last couple of months considering the impact on the rating process of an increase in GST on 1 October 2010.

Initial concerns were that the rates assessments need to be shown inclusive of GST.

However, they have recently received legal advice stating that local authorities can set and assess rates on a "plus GST" basis.

The main concern now is the impact on various rating software systems, which may need to be rewritten within a relatively tight timeframe. They have therefore asked the IRD whether local authorities could have the option of using a composite rate of GST (i.e. half the old rate and half the new rate) for rating charges for the 2010/11 year. However, they do not appear to be very optimistic that the IRD will agree to their request.

If the IRD doesn't agree, GST at 12.5% will apply to rates instalment notices issued before the date of the GST increase (say 1 October) and to any voluntary prepayments of rates before the date of the GST increase. Instalment notices issued for unpaid rates after the date of the GST increase will be at the new GST rate (say 15%). As a result, there will be an incentive for ratepayers to pay all of their rates before the date that GST increases.

Fees and charges

The GST Act contains a transitional provision that allows for fees and charges prescribed or determined under any Act or regulation to be automatically increased for the new rate of GST. However, concerns have

been raised that the automatic increase does not apply to amounts specified as inclusive of GST. Even if the transitional provision does apply, the Act or regulation would still need to be amended in due course to show the updated amount of the fees or charges.

We understand that the IRD are considering this matter. We also understand that Treasury is intending to issue advice to all public authorities about the implications of the increase in GST on fees and charges.

Impact on dividends paid by companies

From the start of the 2011/12 year, the maximum imputation credit ratio for dividends will fall to 28/72. However, companies can continue to pay out imputation

credits at the current rate of 30/70 until 31 March 2013, provided the underlying income was taxed at 30% or 33%.

Impact on deferred tax calculations

The drop in the company tax rate from 30% to 28% applies from 2011/12. However, it should be noted that the new tax rate will be used in deferred tax calculations for 2010/11 and in some deferred tax calculations for 2009/10.

Deferred tax is the amount of income tax payable or recoverable in future periods, and is calculated based on tax rates enacted or substantively enacted at balance date.

For 10M audits, the deferred tax balance should be calculated at 30%, as the change in tax

rates was enacted after balance date. However, the change in tax rates should be noted as a post balance date event.

For 10J audits, the deferred tax balance should be calculated using 28% for long term temporary differences (e.g. PPE) and 30% for short term temporary differences (e.g. holiday pay).

The deferred tax adjustment associated with the change in the tax rate should only be recognised in equity or other comprehensive income to the extent that it relates to reserves that still exist under NZ IFRS. The remaining deferred tax adjustment should be recognised in tax expense, and should be disclosed as a separate item in components of tax expense and the tax note reconciliation.

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