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Prescribed Investor Rate

With PIE's officially starting on 1 October 2007, you may have received queries from clients asking what their Prescribed Investor Rate is.

Individuals

Individual Investors will either qualify for the reduced rate of 19.5% or the default rate of 33% (soon to be 30%). Joint investors are required to use the rate of the highest earning individual.

The chosen rate will be a final tax on the investor's income and they will not be required to show that income in their return. If the fund makes a loss or receives tax credits in excess of tax paid, the investor's share will be credited to the investor in the form of a rebate from the PIE.

An exception to this is that an investor in a Portfolio Listed Company that receives dividends can elect to return the dividends in their return. This is likely to benefit individuals on a tax rate of 19.5%.

Trusts

A Trust can choose a 0% rate or the 33% rate.

If the Trust chooses 0%, then the Trust returns the income less any share of losses in the Trust tax return. Tax credits are offset directly against the income rather than indirectly as a rebate from the PIE.

The other option of 33% will result in a final tax as for 'Individuals' above and the Trust will not return PIE income in the income tax return.

The choice of rate will depend on allocation to beneficiaries of the Trust. For example a Trust may have 19.5% beneficiaries who will be overtaxed if the Trust chooses a 33% final tax. Or, if the Trust is an estate, there may be some benefit of choosing the 33% rate because when the tax rate for PIEs changes to 30%, the Estate will benefit from paying 3% less tax on PIE investments.

A Trust may also benefit from electing to return Portfolio Listed Company dividends in the tax return if these are to be distributed to 19.5% beneficiaries.

Other Entities

Companies, Superfunds, Societies, PIEs and Registered Charitable Trusts all have rates of 0%.

Non-residents have a rate of 33%.

Megan Shaw

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Seminars

Our new round of seminars are scheduled to run over October and November.

They are being held in Auckland, Milford, Tauranga, Hamilton and now in Taupo.

The dates and topics along with the registration form is now available on our website. Alternatively, please e-mail seminars@nsatax.co.nz to be added to our seminar distribution list.

Lara Hartmann**IMPORTANT: Financial Reporting Changes for Small Businesses**

As released by the NZICA on 14th September, small businesses and charities have been given an exemption from compiling financial statements under NZ IFRS from 1 January 2007.

These entities can continue to prepare financial statements under the current framework of FRS's and SSAP's.

Small businesses include small companies, partnerships, trusts, charities, clubs, societies and associations who qualify as small and are not publicly accountable or issuers.

Read the NZICA website at www.nzica.com for more details.

Megan Shaw**Foreign Investment Fund Reference Guide**

We have produced a useful reference guide to assist you to determine whether a client is required to calculate their income from overseas investments under the 'Foreign Investment Fund' ("FIF") rules.

The rules changed from 1 April 2007 for shares held in foreign companies. Prior to that date shares held in companies that were tax resident in 'grey list' countries were exempt from the FIF rules. That grey list no longer applies for shareholdings of less than 10% in foreign companies. But the new rules have introduced a range of different exemptions, with restrictions on who they apply to.

Once it is established that the new FIF rules do apply, then there are 6 different methods for calculating the income under the FIF rules, with restrictions on which methods can be used, and the types of taxpayers who can choose alternative methods.

Our guide, which includes flow charts and examples of the income calculations, will help to determine:

- Whether a client's investments are subject to or exempt

from the FIF regime;

- If the FIF regime applies, which method or methods can be used to calculate the income; and
- Examples of the calculation for the different methods.

The Inland Revenue Department has produced a calculator on its website to calculate the income under the 'fair dividend rate' and 'comparative value' methods. We are pleased to report that we put the examples in our guide into the calculator and it came up with the same income figures. But care needs to be taken to ensure that the correct information is input. One number, value or date wrong will result in a wrong income figure being calculated for the year.

But before you calculate the income, whether you are using the IRD's calculator or some other way, you first need to decide whether the investments are subject to the FIF regime, whether they qualify for an exemption, and which method can be used to produce the best result for your client. This is where our guide will come in handy.

The flow charts cover not only shares in foreign companies (which includes unit trusts), but also the other types of investments that are subject to the FIF regime - interests in foreign life insurance policies and superannuation schemes.

The guide can be purchased for \$350.00 plus GST. To buy a copy contact Julieanne Mollet on 09 309 6505 or email julieannem@nsatax.co.nz.

Gavin Stewart

Transitional Rules – Reduction in Company Tax Rate

The May Tax Bill introduces a number of transitional measures following its announcement of a reduction in the company tax rate from the start of the 2008 tax year.

The changes introduce a "transitional period", starting from the first day of the company's 2008/2009 income year, and ending on 31 March 2010. During this time, companies can impute dividends to 33% to the extent of their pre 2008 tax year imputation credit balances.

While not stated in the draft legislation, what this is likely to mean practically is that two imputation credit accounts will need to be maintained during the transitional period. One for tax paid at the 33% rate, and one for tax paid at 30%.

As an anti-avoidance mechanism, the Bill provides that if dividends that are 33% imputed are paid to shareholder companies (i.e. a holding company) or widely held savings vehicles, then the maximum imputation credit the shareholder company can use is 30%. Therefore, only dividends paid out to individuals, trusts or other entities that are not on the new 30% tax rate can use the old 33% imputation credits.

The question arises then, whether companies with a large retained earnings balance should pay out dividends before 31 March 2010 to ensure the highest tax credit is passed out to shareholders. If dividends are paid to shareholders on a 39% marginal tax rate, any dividends paid before 31 March 2010 will trigger an immediate 6% tax liability.

However, if dividends are deferred until after the transitional period then a further 9% tax liability will arise to shareholders (assuming there continues to be a disparity between the top marginal tax rate and the corporate tax rate). We recommend that companies consider whether it is worthwhile paying out retained earnings prior to 31 March 2010.

The Bill also introduces an imputation credit account penalty tax specifically for the transitional period, where 10% tax will be payable if companies put their pre 2008 tax year imputation credit account into debit through paying 33% imputed dividends when there are insufficient credits in the imputation credit account.

One further change is that payment of Qualifying Company Election Tax ("QCET") now creates a credit to a Qualifying Company ("QC") or Loss Attributing Qualifying Company's ("LAQC") imputation credit account. As you are probably aware, QCET is required to be paid on (basically) a company's unimputed retained earnings and related party capital gains on entering the QC/LAQC regime. Previously, the payment of QCET did not give rise to a credit to the company's imputation credit account.

However, under the new change this will create a credit, on the date the QCET is paid. And unfortunately this change applies to all payments from 17 May 2007. As the qualifying company regime provides that distributions from QC's and LAQC's are taxable to the extent of any available imputation credits, QC's/LAQC's will first have to use the QCET generated imputation credit before they are able to treat distributions as (tax free) capital distributions. For shareholders on a 39% marginal tax rate, this means an immediate 6% further tax liability.

Maggie Jaques

Trusts and Beneficiary Income

Trustees of trusts with standard balance dates need to have taken sufficient steps to distribute income before 30 September to enable the distribution to be classified as beneficiary income.

Where it is unlikely that the trust's accounts will be finalised before 30 September, the trustees will need to resolve to distribute amounts to beneficiaries on say, a percentage or proportionate basis. So long as the trustees resolve before 30 September and there is some identifiable formula for calculating the distribution, this will be sufficient to satisfy the requirement for the income to be paid and applied within six months of balance date.

Keith Turner