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Phil Walker

As many of you may be aware, Phil Walker has been away from the office for the last five weeks with a disease of the bone (Chronic Osteomyelitis) in his lower leg. Whilst not life threatening it is a very serious condition. Phil has spent most of the last five weeks in hospital with some fairly extensive surgery undertaken on 17 September. Phil is convalescing at home now but isn't expected back for another couple of weeks, and even then he will be restricted to light duties.

Meanwhile nsaTax keeps ticking along so feel free to contact one of the other Tax Directors (Graeme Carruthers, Keith Turner or Phil Bell) with any tax queries you may have.

Not so simple for Simon when he met the PIE man!

The tax rules for portfolio investment entities (PIEs) came into force almost a year ago now on 1 October 2007. The aim of the rules is to allow investors in collective investment vehicles (eg, managed funds) to be taxed on their investment earnings in a manner similar to those who invest directly. However ensuring that the correct amount of tax is paid by you or your clients as investors may not be as simple as it first appears. This article focuses on PIEs that are Portfolio Tax Rate Entities (PTREs) and the impact on investors in PTREs.

Individual investors who have, in either of the previous two years, both (a) a total income of \$38,000 or less, and (b) total income plus share of PIE income of \$60,000 or less, will be able to elect to be taxed at 19.5 percent. Income attributable to companies and trusts will be taxed at 0 percent and a tax return will be required to be filed including PIE income. Trusts can however elect a rate of 30% which will mean PIE income is excluded income and does not form part of the return. Income attributable to all other investors in the PIE will be taxed at 30 percent, the default rate.

Where an individual investor has elected the correct rate, the income will be excluded. "That's simple" says Simon. However, the key is ensuring that the investor is on the correct rate. For example, if your client is on the default rate of 30% but could have elected 19.5%, there is no ability to benefit from the tax credit of 30%. The income is excluded income. Conversely, your client elects a rate of 19.5% due to income levels in the previous two years. However, in the current year, income is \$100,000. This means the rate is not correct for the period in which the income is allocated by the PIE. Consequently the income must be included in the return. In addition, assuming the calculation period is quarterly, you may find that in one quarter the correct rate is used (say 19.5%) but in the second quarter due to an increase in income, the rate is incorrect. Thus you may find one quarter is excluded income and the other is not.

Investors will therefore need to notify the PIE of any change in rates as soon as possible and advisors will need to ensure they are kept informed of PIE investments and rates adopted. If you need any assistance in this area or require a review of PIE reports received for your clients, please contact your nsaTax advisor.

Lisa Murphy

Directors:

Phillip Walker

Philip Bell

Bruce Watt

Graeme Carruthers

Keith Turner

Associate:

Lisa Murphy

Products for Sale

FIF Guide for the new rules -
\$350 plus GST

Please contact Nicki Watson,
nickiw@nsatax.co.nz to obtain a
copy

Share Valuations and Discounts for Lack of Marketability and Lack of Control

The concept of discounts applying to minority ownership interests is generally well understood. Control usually gives certain rights eg:

- Appointment of management, directors
- Liquidate, sell out, merge, recapitalise
- Determine operational and strategic policy
- Declare dividends

Accordingly, a minority ownership interest will typically be worth less than the equivalent ownership interest in the entire business enterprise.

The concept of a discount for marketability is generally well understood. The two are separate concepts, although there is some interrelationship between them. The concept of marketability deals with the liquidity of the ownership interests, ie how quickly and certainly it can be converted to cash. The base from which the discount should be subtracted in the value of an entity or ownership interest that is otherwise comparable but that enjoys higher liquidity. There are two general types of empirical studies designed to quantify the discount associated with the lack of marketability of minority ownership interests in closely held businesses.

1. Discounts on the sale of restricted shares of publicly traded companies.
2. Discounts on the sale of closely held company shares – compared to prices of subsequent initial public offerings of the same company's shares.

Average discounts observed in these studies range between 25% to 35%.

Whilst such studies and the resultant observations can only be used as a guide it is reasonable to conclude that lack of marketability (particularly in small privately held companies) is a significant factor in determining the specific risk of investment and in turn the capitalisation rate or earnings multiple.

Bruce Watt**Planning on a Company Restructuring – Do it Now!**

The proposed changes to the associated persons definitions have received considerable publicity in respect of their impact on land dealers, developers and builders. Less publicised but equally significant is the proposal to replace the relatively narrow definition of related person in the dividend rules with the wider associated persons definition applying from 1 April 2009.

Under the dividend rules, a company can distribute capital gains tax free in the course of liquidation. The definition of capital gain excludes capital gains realised in a transaction with a "related person", except

Directors:

Phillip Walker

Philip Bell

Bruce Watt

Graeme Carruthers

Keith Turner

Associate:

Lisa Murphy

where the company is a close company and the gain is realised in a transaction with a related person other than a company in the course of liquidation.

The present definition of related person is relatively narrow and therefore easy to structure a non-related purchasing entity.

However, it is proposed that the new definition of associated persons will replace the related person definition for the 2009/10 and later income years.

Given the wide reaching impact of the associated persons rules, it will be virtually impossible to break the definition in a group context.

Although it may be possible to deal with the related person issue under the Qualifying Companies regime, this can often require lead in time if the vendor company is not already in the regime or it could result in capital gains being distributed to trust beneficiaries which may not be desirable from an estate planning or asset protection perspective.

If you have clients with companies who are looking to restructure where capital assets such as land and buildings, intellectual property, goodwill or shares could be transferred realising a capital gain, then we strongly recommend that you consider tackling the restructure before these changes take effect as it may save a lot of headaches dealing with the existing narrow related person definition.

Graeme Carruthers

Seminars

A reminder that our Spring Series of 2008 seminars are now scheduled with the following topics:

- Buying and Selling a Business;
- Tax Update;
- Land Issues;
- Tax Disputes Process; and
- Associated Persons and Restructuring Issues.

These begin in October. If you wish to register please see the registration form attached within our newsletter e-mail.

Lara Hartmann