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Budget 2011

The budget was announced on Thursday 19 May 2011. Unlike past years, there was very little in the way of tax changes this time around, save for mention of some discussion papers that will be released later in the year. We summarise the tax issues below.

IRD Funding

Special mention was made of the extra funding of \$119.3 million allocated in the 2010 budget to the IRD for extra compliance funding over four years. This has produced an extra \$115.2 million in tax revenue generated or recovered in the first 9 months of the extra funding allocation.

The focus so far has been on the horticultural and hospitality industries, land transactions, foreign investments and debt collection. These areas and the hidden economy will no doubt continue to be targeted over the next three years.

KiwiSaver

Currently the 2% compulsory employer contribution to KiwiSaver has been exempt from the Employer Superannuation Contribution Tax (ESCT). Any contributions in excess of the compulsory 2% have been subject to ESCT.

From 1 April 2012, all employer contributions will be subject to ESCT. This means that from 1 April 2012 an employee on the top rate of ESCT will get 67% of their employer's contributions paid into their KiwiSaver account.

Other KiwiSaver changes include the Government's contribution by way of a tax credit will be halved to \$512.50 for year ending 30 June 2012, and from 1 April 2013, the minimum level of employee and employer contributions will increase to 3%.

Working for Families

Currently the Working for Families tax credit starts to abate at the rate of 20% when income is over \$36,827. That threshold will progressively reduce to \$35,000 and the rate of abatement will increase to 25% progressively over the next four inflation adjustments. The next inflation adjustment will be on 1 April 2012, and the next three are anticipated at two-yearly intervals. An inflation adjustment is made when the CPI inflation cumulatively reaches 5% or more.

Thin Capitalisation

The minimum equity percentage for foreign-owned banks is to rise from 4% to 6%. This is the minimum prescribed equity before the thin cap rules limit a foreign owned bank's interest deductions.

Discussion Papers

Discussion papers will be released later in the year to look at:

- Whether the value of fringe benefits provided to employees should be added to income for calculating their working for families tax credit entitlement;
- The tax treatment of mixed-use high value assets used for both business and private purposes, e.g. yachts and holiday homes; and
- The tax treatment when farmers switch livestock valuations between the herd scheme and national standard cost scheme.

Gavin Stewart

LTC Update

We have received a response from the IRD to our second submission seeking clarification of some aspects of the new Look Through Companies (LTC) regime, in particular the owners basis calculation.

IRD have confirmed that it is intended that those QC's that transition to an LTC in either the first or second income year starting after 1 April 2011 can calculate their "initial basis" by including in the investments component of the formula the market value of their shares in the company at the end of the year preceding the transitional year and this effectively becomes the base year from which the other items on the formula are calculated.

While we accept that this was the policy intent, our point was that the legislation as currently drafted does not achieve this outcome. The IRD do not agree and consider that the legislation does achieve this.

The other point of clarification concerned the calculation of the "secured amounts" component of the owners basis formula.

Take the following example. An LTC is owned 50% each by a husband and wife. The LTC has debt of \$500k which is secured by way of personal guarantee provided by the husband and wife and secured over the family home which has a market value of \$750k.

The "secured amounts" for each shareholder is the lesser of the following amounts:

- (a) \$500k being the amount of the LTC debt secured by guarantees
- (b) \$250k being the amount of debt divided by the number of guarantors (2)
- (c) \$750k being the market value of the property securing the guarantee
- (d) \$375k if the family home is owned jointly or the proportion of the \$750k attributable to each shareholder if owned as tenants in common in different shares

If the family home is instead owned by a family trust which has also guaranteed the LTC debt, we queried how item (d) in the formula would

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be calculated for the husband and wife given that they didn't own the family home. We thought there were three possible interpretations; the husband and wife could each be attributed with the value of the trust property i.e. \$750k, it could be apportioned 50/50 i.e. \$375k each or worst case scenario, they could get nothing.

The response from IRD was that paragraph (b) in the example above would be reduced from \$500k to \$167k as the number of guarantors increases from two to three, but that item (d) would be not applicable because the trust was the only guarantor in relation to the trust property, there was not a "number of guarantors" using this amount in (c) to secure their guarantee so there is no need to apportion.

If you didn't follow the above rationale then you are not alone as neither did we. What we can take from the response is that IRD did not seem to think the worst case scenario applied which leaves the first and second options, either of which we can live with.

If you attended (or are about to attend) our recent LTC workshops, you will be aware that you will need to address each item of the owners basis calculation in order to ascertain whether the loss limitation rule will apply to limit deductions under the LTC regime before you recommend the LTC option to your clients.

It is important to consider the costs of entry to and exit from the LTC regime because unlike the old QC rules, once you elect in then you are in for at least the first year and you cannot elect out retrospectively. Once you exit, there is a deemed disposal of all LTC assets at market value which could have significant consequences, particularly if the LTC owns revenue account or depreciable property.

Graeme Carruthers

Loss Limitation Calculator Now Available

If you aren't familiar with the owners basis calculation (and you need to be) or you are considering whether to transition to an LTC, you will likely benefit from nsaTax Ltd's loss limitation calculator which we have for sale for \$250.00 including GST. If you would like to purchase the calculator, please contact Lara on 309 6505 or email her at larah@nsatax.co.nz.

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Upcoming Webinar – Recent Tax Changes – 8 June 2011

We are about to run a webinar in conjunction with Business Fitness NZ Limited. We will be reviewing the new tax legislation that has emerged over the past year and will focus on issues you must be aware of with regard to the GST changes, the LTC regime and other law changes.

For full details, or to book, please visit the Business Fitness website at: www.businessfitness.co.nz/client_development/webinar_programme