

health adviser

Grant Thornton 

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Managing your Tax Payments

Often we see clients who have focused so intently on the growth and management of their business, that the available funds required to meet their ongoing tax obligations cannot be sourced. In fact, upon discussions with some people, the Inland Revenue falls at the bottom of their list of creditors. This is a dangerous game to play as the Inland Revenue have the ability to seek recovery of unpaid taxes - no matter what the costs to the taxpayer.

Managing these obligations has become a little easier in recent times through the establishment of Tax Management NZ Limited (TMNZ) - a tax-pooling intermediary between taxpayers and the Inland Revenue.

Essentially TMNZ accepts tax payments on behalf of taxpayers (predominantly large corporates) and sells overpayments that are made for a greater interest rate than what the Inland Revenue pays. These overpayments can then be "bought" for an interest rate that is lower than what the Inland Revenue charges. This can be achieved due to the significant margin that the Inland Revenue has between their credit and debit interest rates. The end result is that this service provides the ability for reducing your final bill with the Inland Revenue through the benefit of hindsight.

TMNZ is Inland Revenue approved and all payments are handled by the New Zealand Guardian Trust Company. Guardian Trust:

- holds all payments and tax deposits on trust for the members;
- maintains core client details and tax registers;
- holds all deposit bank accounts;
- holds the TMNZ tax account at Inland Revenue;
- authorises all payments; and
- authorises all transfers to taxpayer accounts at Inland Revenue.

Consider the following simple example:

- ABC Limited has a March balance date and pays 2006 provisional tax based on the previous year's tax return of \$50,000 at each instalment.
- When the actual liability is determined they discover their total tax bill is double what they expected (\$300,000) - therefore they are exposed to interest on the \$50,000 shortfall at each instalment.
- If payment was made directly to the Inland Revenue in March 2007, the total amount required would be \$176,016 (\$150,000 of core tax and interest of \$26,016).
- Through the use of the services at TMNZ this interest bill could be reduced by approximately 22%, meaning that the total payment required to settle the same debt would be \$170,216 - a saving of \$5,800.

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Tax Update:

New rules for offshore portfolio investment in shares and new tax rules for portfolio investment entities

The following is an update for investors on the changes to offshore portfolio investments (effective 1 April 2007) and the new Portfolio Investment Entities "PIEs" (effective 1 October 2007).

Offshore portfolio investment in shares

A lot of investors with offshore portfolios have been exempt in the past as their shares have been with companies located in "grey list" countries (Australia, Canada, Germany, Japan, Norway, Spain, United Kingdom, United States of America).

For holdings held in the grey list countries, income was taxed on a "realised" basis either by way of dividends received, or on realised gains and losses (if held on revenue account).

As from 1 April 2007 (the first tax return affected will be for the year ended 31 March 2008) the "grey list" no longer exists except for investments in Australian resident and listed companies. For all investments other than those in New Zealand entities and Australian listed entities, income must be returned on an "unrealised" basis (i.e. whether you have received a dividend or not) generally using the "fair dividend rate method", as described below.

However, these new rules will not apply to individuals, and a very limited number of trusts, who hold investments costing NZ\$50,000 or less. Note that a couple may qualify for a \$100,000 threshold in respect of "jointly" held investments.

What is the Fair Dividend Rate method?

This method is used for offshore portfolio investments which have readily available market values (such as through share markets). Under this method a taxpayer will be taxed on a maximum of 5 percent of the opening market value of their offshore portfolio investments each year i.e. whatever investments are held on 1 April each year will determine the tax liability for the year, whether they continue to be held for the year or not. For individuals and certain family trusts, if the total gain, dividends and unrealised capital gains, is less than 5 percent then tax is payable

on this lower amount. If the investment make a loss then no tax is payable. There is no deduction available for any loss.

Overseas shares are "assessed" under the fair dividend rate on a "global pool" basis rather than a share-by-share basis. This means a taxpayer is not able to pay tax limited to a 5% return in respect of a share that has actually made a return greater than 5% while paying no tax on a share that has made a loss. Rather the returns (both positive and negative) must be aggregated for the purposes of working out the actual return on the portfolio as a whole.

For offshore portfolio investments for which it is not possible to obtain market values except by independent valuation (such as investments in private companies) the cost method is to be used.

What is the Cost Method?

This method taxes 5% of the cost of the portfolio investment each year (again for investments held at 1 April each year) plus an uplift of 5% each year to account for investment growth. There is limited ability to take account of returns below 5% or losses (except a revaluation once every 5 years).

Tax Reporting/Accounting Requirements

The Inland Revenue has yet to provide guidance on the reporting requirements under the new rules. However based on our understanding of these rules it would appear that the following would be required:

- Market valuations of overseas share portfolios (or adjusted cost price where the cost basis is used) as at 31 March 2007 to set the starting values.
- Actual "performance" of the investment portfolio detailing opening and closing market values and any dividends received during each income year (commencing 1 April 2007).
- Details of any purchase and sales of investments made during the income year ("quick sales"). This is to stop people manipulating the system through not holding investments at

1 April each year - they will be caught and taxed on the lesser of their actual gains on sale of 5% of the cost of the shares sold.

We understand that most major investment managers will be providing this information to their clients as part of their service. If you do not use a manager for your investments then you should ensure that you have the details available so that you can make the calculations above.

Portfolio Investment Entities ("PIEs")

The acronym PIEs was chosen to replace its forerunner QCIVs (Qualifying Collective Investment Vehicles) possibly in an attempt to convince people that because it rolled off the tongue easier it was conceptually simple. Fortunately PIEs and QCIVs are both conceptually simple but in practice PIEs present many difficulties both for the PIEs themselves and for the Inland Revenue to administer.

The purpose of the PIEs rules is to reduce the tax rate on investments to that applying to the investor (capped at 33%) and remove tax on capital gains if the investor is not a trader in investments.

An entity is eligible to elect to become a PIE if it is a company, unit trust, superannuation fund, or group investment fund that:

- is established for the principal purpose of savings and investment by deriving certain types of investment income (generally all investment income except direct investment in land);
- has a minimum number of investors (normally 20);
- does not have a controlling interest in investments;
- does not issue separate classes of interest to investors; and
- is a New Zealand resident for tax purposes.

The PIE "regime" commences from 1 October 2007. (Continued on Page 4)

How would your practice stand up to the Inland Revenue's scrutiny?

In today's commercial environment, business is more and more about identifying, managing and reducing risks. The risk and potential exposure that Inland Revenue imposes on businesses with their audits on various tax types are threats that many businesses do not prepare for. The costs associated with an audit and the flow-on implications of "problem areas" identified by the Inland Revenue can rapidly accumulate. This is not taking into account any of the consequences that are linked to the new penalty regime, which on their own have the ability to cripple a business.

The Inland Revenue tends to target a standard set of problem areas when conducting an audit. The top largest issues identified by the Inland Revenue during investigations for Small to Medium Enterprises (SMEs) in 2006 for income tax and GST were:

Income Tax

- Omitted income
- False documents
- No records held to substantiate expenditure
- Tax avoidance arrangements
- Depreciation disallowed
- Losses carried forward disallowed
- Interest disallowed
- Capital expenditure disallowed.

GST

- Omitted income
- Change in accounting basis
- GST inputs - exempt expenditure claimed
- Taxpayer arithmetical error
- Tax avoidance arrangements
- Land and sub-division sales treated incorrectly
- No taxable activity
- Inputs overstated.

Grant Thornton can perform a "health check" to review these particular areas and find out if there are any procedural or general errors that should be remedied. This would involve us coming out to your premises and effectively completing a "dummy audit" for a particular tax type and period.

What return do you get on your investment?

Peace of mind!

By being proactive rather than reactive you will be able to identify whether the current processes and procedures you have in place are appropriate and will be able to stand up to Inland Revenue scrutiny.

If problems are identified you will be able to fix them voluntarily. Voluntarily disclosing errors to the Inland Revenue reduces any potential penalties that they choose to impose by 75%, so the option is certainly well worth your while.

As part of the health check we will provide you with an indepth report detailing what we have found, if anything, whether the procedures you have in place are appropriate and possible solutions to reduce your exposure to the Inland Revenue.

Please contact your local Grant Thornton adviser to discuss whether a health check is a viable option for your organisation.

Managing your Tax Payments

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In instances where payments have been made late, or not at all, and a penalty exposure exists, the savings will be even greater, as purchasing "old tax" will mitigate the penalties in most cases.

The services of TMNZ need not be limited to purely income tax, but can be used effectively in respect of other tax types also. It is often a cost reducing option in the instance that the Inland Revenue conduct an investigation and locate an historic discrepancy.

TMNZ also offer a service that can assist clients who are aware of an upcoming tax liability that they have, but have cash flow problems. This is known as a Tax Option.

For further details about whether TMNZ could provide cost savings for you, contact your local Grant Thornton adviser.

Tax Update (Continued)

Payment of Tax by PIEs - PIEs as "entities" will not pay tax themselves and the income derived by the PIEs will notionally "flow through" to the individual investors. These investors will pay tax (through the PIE) at their Prescribed Investor Rate ("PIR") and the PIE will pay this tax onto Inland Revenue. There will only be two PIR rates:

- For taxpayers whose income other than from PIEs is less than \$38,000 - 19.5%.
- For taxpayers whose income other than from PIEs is greater than \$38,000 - 33%.

It will be noted that there are only two PIR rates (as opposed to three income tax rates). There is no 39% rate meaning that the maximum rate that investors will pay tax is 33%. Therefore there may be significant tax advantages in taxpayers investing through PIEs rather than investing directly. However these benefits would have to be weighed against the extra costs that will be incurred by the PIEs on behalf of the investor (such as management fees).

It appears that in most cases this "PIE tax" will be a final tax and investors will not be required to file a tax return with Inland Revenue nor will the PIE income have to be included in any individual income tax return that has to be filed by the investor for other reasons. The income from the PIE will not be taken into account for "other purposes" such as family support, child support, student loan repayments etc.

Obviously it will be up to the investor to inform the PIE of their correct PIR rate. It is expected that if the investor PIR rate is not correct then the Inland Revenue will contact the investor direct.

General - There is a huge amount of work to be undertaken so that both the PIEs themselves and Inland Revenue are ready and fully operational for the 1 October 2007 implementation date. There is also a lack of material published by Inland Revenue regarding the practical implication of the PIE regime at this stage. This is understandable as the legislation was only finalised and enacted in December 2006. Over the next 6 months it will be very much a case of "watch this space" and we will keep you informed of any developments or updates.

Personal Property Securities Act 1999 - Renewing your Financing Statements

The Personal Property Securities Act was passed in 1999 and came into force on 1 May 2002. From this date it was possible for companies to register their security interests on the Personal Property Securities Register, which is the centralised electronic register that is run and maintained by the Ministry of Economic Development. All security interest registrations that are created have an automatic expiry date, being exactly five years from the date of registration. This means that as from 1 May 2007, any registrations made on or after 1 May 2002 will automatically expire, and priority will be lost unless they are renewed prior to the date of expiry.

The PPSR site (www.ppsr.govt.nz) has a link to FAQs on renewals and provides answers to the following questions:

1. When do my financing statements expire?
2. What do I need before I renew my financing statements?
3. How do I renew my financing statements?
4. What does it cost?
5. Where can I get more information?

If you enlisted the help of an advisor to register your initial Financing Statements, they should be able to assist with the renewals, however the above FAQs will help guide you through the process to do-it-yourself via the PPSA website.

If you require further information on any of these topics or would like details on other accounting matters, contact your local Grant Thornton firm:

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