

health adviser

Grant Thornton 

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KiwiSaver for the non-employee

KiwiSaver has been with us for a short time and it still has everybody talking. A New Zealand Government press release noted that within the first five weeks of its launch, nearly 92,000 people had signed up for the scheme. Have you?

There has been a lot of information available for employees and employers, but what about the self-employed? To a certain degree, being self-employed (including those that are shareholder-employees) brings with it different considerations. That is not to say there are not significant advantages for joining. Some may argue that it provides more flexibility as you are not bound by the 4% minimum contributions that employees would have to make.

A shareholder-employee, who is not subject to PAYE, must contract directly with a KiwiSaver provider as deductions cannot be paid to the Inland Revenue with the monthly PAYE. For a shareholder-employee, the company is not entitled to an income tax deduction for any contributions they make and would not be entitled to the employer tax credit from 1 April 2008 (assuming legislation is passed).

The shareholder-employee contracts directly with a scheme provider and can make voluntary contributions directly, or via the Inland Revenue. They are also entitled to the \$1,000 kick-start, the fee subsidy of \$40 per annum and the member tax credits (maximum \$1,042.86 pa).

The contributions do not need to equate to 4% of their income, but if they are contributing, where possible they should maximise the Government's member tax credits (\$1,042.86pa), which means personally contributing at least \$20 per week. Ignoring the initial \$1,000 kick-start, with the member contributing at a level of \$20 per week, the member tax credit allows you to double your money each year, before any growth is factored in.

The same applies for those who are self employed and may not be operating through a company structure.

On the other hand, shareholder-employees who are paid through the PAYE system can enrol in the same manner as any other employee and the company would pass on the KiwiSaver contributions to the Inland Revenue through the PAYE system. The company can also make employer contributions and assuming the legislation passes, would be entitled to the employer tax credit from 1 April 2008. Employer contributions made on behalf of shareholder-employees are tax deductible to the company.

There are specific rules that relate to shareholder-employees, how they take drawings and the rules relating to PAYE, and it may not be as simple as "switching" to become a shareholder-employee with PAYE deducted.

As there is no "one size fits all" answer when it comes to KiwiSaver, each case should be addressed individually. Contact your Grant Thornton Adviser for further information.

Changes to partnership rules

The Government has recently introduced to Parliament the Limited Partnerships Bill. The key feature of the Bill is new limited partnership rules to replace the outdated special partnership regime. The aim of the proposal is to improve the ability of New Zealand entities to access foreign investment capital by providing a legal and tax structure which is familiar to international investors.

The Bill also clarifies and modernises the tax treatment of general partnerships, with the aim of providing greater certainty and reduced compliance costs.

The changes are due to apply from 1 April 2008.

Limited partnerships

A limited partnership is a hybrid entity with corporate and partnership features. Like a company it will be a separate legal entity. It must register with the Registrar of Companies and will have similar compliance obligations. However, income and expenses will flow through to the partners in accordance with the partnership agreement and each partner will be taxed individually, similar to a general partnership.

A limited partnership has two types of partners:

- **General partners** - who act as agents of the limited partnership and manage the business and partnership property. They are jointly and severally liable for the debts and obligations of the partnership to the extent that the limited partnership itself cannot pay its debts and liabilities;
- **Limited partners** - who provide money and/or assets but are prohibited from participating in the management of the limited partnership (with certain "safe harbour" exceptions). They are liable for the partnership's debts and obligations only to the extent of their investment. Income tax losses can be claimed, but only to the extent of the limited partner's "economic loss", with any excess carried forward to future years.

Internationally limited partnerships are the preferred structure for venture capital investment, and having access to a New Zealand version will enable businesses to compete more easily in this market. A limited partnership may also be a useful alternative to a company, trust or joint venture structure in other contexts.

Reform of general partnership tax rules

The remaining reforms affect both limited and general partnerships and seek to codify and clarify the tax rules affecting partnerships generally.

Definition of "partnership"

A general definition of "partnership" will be added to the legislation to ensure the new rules apply not only to registered limited partnerships, but also to New Zealand resident partners of certain foreign general and limited partnerships, and to certain joint ventures and co-owners of property where the members have elected to be treated as a partnership.

Flow-through tax treatment

The Bill confirms that partnerships are to be transparent or "look-through" for tax purposes, clarifying that every item of a partnership is to be attributed to the partners in accordance with their partnership share. Accordingly, income, expenditure, gains, losses, tax credits and rebates will be allocated amongst the partners while preventing the streaming of specific items to specific partners. A departure from the current rules will see partners able to deduct expenditure incurred by the partnership prior to that partner becoming a member, subject to normal deductibility criteria.

Entry and exit of partners and changes to partnership interests

Under current law, a partnership is technically dissolved when partners enter or exit the partnership. This legality is often ignored in practice, with the partnership continuing largely unchanged.

The proposal clarifies that for tax purposes a partnership will be dissolved only where 50% or more of the total interests in the partnership are disposed of within a 12 month period. In this instance, each partner is treated as disposing of all of their partnership interests to a third party and immediately reacquiring those interests, all at market value.

Where less than 50% of the total partnership interests are disposed of, only the outgoing partners will be required to account for tax on disposal, and only then where the disposal proceeds exceed the tax book value of their share of the partnership property by more than \$50,000.

An exiting partner will not have to account for tax on the disposal of trading stock, depreciable tangible property, certain financial arrangements and excepted financial arrangements, and specified livestock, where specified thresholds and criteria are met.

Where the exiting partner does account for tax, an adjustment to the partnership's asset and liability cost base will be required to reflect the deemed disposal value to the outgoing partner.

The new exit and entry rules will be elective for general partnerships with five or fewer partners. The rules will be mandatory for a partnership where any partner has limited liability.

Other changes

Further proposals clarify and simplify the record keeping and filing requirements for partnerships. In addition, transitional rules will be brought in for existing special partnerships that transition into limited partnerships.

Investing 101

Investment management is just one component of a six step comprehensive financial planning process.

In this article we begin with investment basics, however in later articles we will explore in greater depth a number of the key issues around successful investment strategies and management.

Emergency funds

It is important to have an ability to access liquid funds at short notice to cover any unplanned financial emergencies that might arise. An old rule of thumb is to set aside an amount equal to three months net income. Ideally these funds can be held in a high interest rate savings or cash account. With New Zealand interest rates amongst some of the highest in the Western World today, there are plenty of 'on call' options offering close to 8.00% pa interest.

Other investors simply prefer to have a facility available that can be called upon at short notice if required. Credit card or revolving credit facilities can be useful here but discipline is needed to ensure they are cleared regularly at month's end to avoid the imposition of excessive compounding interest rates.

Investment goals

You need to clearly identify what you are trying to achieve with your investment portfolio. This will help to keep you focussed when markets turn against you as they inevitably they will do at some stage. Clearly define the purpose of the investment. Do you need income, capital growth or a bit of both? How liquid does the investment need to be? You need to work through all of these questions so you can develop your own personal investment strategy.

Your personal risk profile

Higher returns can help you to achieve your goals more easily, but with higher returns there comes higher risk. So you need to be comfortable with the level of investment risk involved. Many refer to this as the "sleep test". If you are going to loose sleep over your investments then you probably have too much risk in your portfolio. So what sort of investor are you and how much investment risk can you afford to take? Often the answer to this question depends upon your stage in life as the closer you get to retirement the less risk an investor usually wants to take. For those of you just starting your careers, then obviously you can afford to take on a reasonable level of investment risk and use the volatility of the markets to your advantage over time, so long as you have matched your risk profile to the investment term objectives described below. There are a number of questionnaires (which some organisations use) to determine investors tolerance to risk.

Investment term

It is important to consider investment term when developing your strategy. If your investment goal is short term, say under three years, then your strategy should reflect that. Income assets such as cash, enhanced cash and fixed interest investments are ideal short term investments as they have very low volatility and produce consistent returns. Growth assets by nature are more volatile as markets move every day, so growth assets require longer durations to achieve their desired results. You do not want to be in a position where you are forced to realise an investment at the worst possible time, so matching your investment term to your investment goals is essential.

Diversification

Diversification is a must in any investment portfolio. Diversification reduces portfolio risk, by spreading your investment across different assets classes, such as cash, fixed interest, shares and property. Not all assets will perform at their optimal level at the same time as markets move in cycles. By spreading your investments across these different asset classes 'smoothes' the portfolio returns.

Diversification can be used at a number of different levels. Firstly by asset class then by sector, geographic location, by region, by industry type and so on. Every time a new layer is added portfolio risk is reduced.

Regularly review your strategy

As investment markets are dynamic, it is important to have a regular review process in place to revisit all of the matters covered above, to take into account any change in your personal circumstances and to make any appropriate adjustments to your portfolio. Whether you are managing your portfolio yourself or have sought the use of a professional, regular reviews are an essential part of the process to ensure that you maximise returns.

Survey shows likelihood of high business ownership churn

The latest findings from the Grant Thornton International Business Report show that 51% of the New Zealand businesses surveyed expect an ownership change, second only to South Africa, where the comparable figure is 52%, and ahead of Canada (50%).

Countries showing the lowest rates of expected ownership movement in the coming 10 years were India (10%), Russia (11%) and Greece (12%).

In **New Zealand**, most businesses thought that a shift in ownership would take place within the **next three to five years**, rather than in a six to ten year span.

The consistency in the New Zealand results show that there is a predominant sale-of-company mentality among New Zealand businesses.

These findings repeat the message that many businesses are being operated with a company-for-sale outlook uppermost in the minds of the owners. This in turn can translate into a lack of long-term strategy and development.

The figures give substance to the general view that there is high ownership churn in this country. The effects of this can often be unsettled employees and poorer productivity downstream.

New Zealand companies, in common with the overall international findings, saw a trade-sale as their most likely future in the event of an ownership change.

However, although a purchase by private equity or bank investors was the second most tipped form of ownership change, a reasonable number of businesses surveyed thought a possible sale option could be to fellow family members, an employee or management buyout.

New PIE rules for investors

From 1 October 2007 New Zealand managed funds that meet qualifying criteria can elect to become Portfolio Investment Entities ("PIE's").

This should be advantageous to investors in those funds. A PIE will cease being taxed on capital gains made on the disposal of most Australasian shares. In addition, the income of the PIE will be attributed to investors and will essentially be taxed by the PIE at investor tax rates.

Investors will be asked to provide the PIE with their IRD number and the Prescribed Investor Rate ("PIR") to be applied to their PIE income. The PIR for an investor will be:

- 19.5% for a New Zealand resident individual who, in either of the last two tax years, had taxable income from non-PIE sources of \$38,000 or less and total income (from PIE and non-PIE sources) of less than \$60,000;
- 0% for PIE's, companies, charities, superannuation funds and New Zealand resident trusts which do not elect a 33% PIR. Investors with a 0% rate must account for their own tax;
- 33% in all other cases (30% from 1 April 2008). This is also the default rate where an investor does not provide a PIR.

Provided the correct PIR is used, investors with a 19.5% or 33% rate will not generally be required to include PIE income in their tax return. PIE income will not affect the calculation of family assistance, student loan repayments and child support.

Choosing the wrong PIR could have adverse consequences. Please contact your Grant Thornton Adviser if you wish to discuss this further.

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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