NEW ZEALAND BUDGET 2010

TAX PACKAGE HIGHLIGHTS & INTERNATIONAL ISSUES

Tax reform was the focus of the 2010 Budget. This first term National Government (currently in its second year of a three year election cycle) delivered further on election promises of personal tax cuts. Budget 2010 is aimed at international competitiveness, productivity and growth, encouraging saving rather than spending and removing distortions in the tax system around property investment.

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The Government wants New Zealand's tax system to be competitive internationally, while still generating tax revenue from inbound investment. The primary initiative is to cut the company tax rate from 30% to 28%, effective for most companies from 1 April 2011. This is an accelerated version of the Australian corporate tax rate cut, which is to take place by mid-2014.

Across the board personal tax cuts are intended to encourage skilled workers to either come to or remain in New Zealand. The second initiative is to focus on inbound debt investment and amend New Zealand's thin capitalisation rules.

Interest deductions are limited where a New Zealand entity is more than 60% debt funded. This is down from the previous "safe-harbour" level of 75%. The worldwide group debt percentage appears to remain at 110% (i.e. the New Zealand entity's debt level can be up to 110% of the group average).

As both tests must be breached, the target remains New Zealand companies that are highly geared compared with their offshore group counterparts. Remaining changes are adjustments claimed to achieve fairness and economic growth.

Preceding the Budget, a Tax Working Group of independent tax experts with tacit Government approval was created to recommend improvements to the tax system. Their recommendations were for fundamental changes.

However, a radical reform agenda to establish a broad based capital gains tax, land tax, or other real changes in direction were quickly ruled out by the Government. Accordingly, the Budget is a series of incremental initiatives designed to encourage productivity and promote saving over spending by increasing GST (New Zealand's VAT), and lowering personal and corporate taxes.

Some tax planning structuring incentives have been removed together with attempts at altering New Zealand's bias towards property investment, but with limited effects.

TAX CUTS

Individuals	As follows from 1 October 2010
$0 - $14,000	10.5% - down from 12.5%
$14,001 - $48,000	17.5% - down from 21.0%
$48,001 - $70,000	30.0% - down from 33.0%
Over $70,000	33.0% - down from 38.0%
Companies	28% from 2011/12 income year
Trusts	33% unchanged

TAX CUT NOTES

Companies

- The new company rate will also apply to Portfolio Investment Entities and other widely-held investment vehicles, essentially allowing investors to effectively "cap" tax at 28%.
- A two-year transitional period will apply to use imputation credits on company tax paid at the old 30% rate when paying dividends.

Individuals

* Marginal tax rates are reduced across the board to compensate for GST increasing (and more for higher rates).

- This is also coupled with an automatic 2.2% increase to benefit, superannuation and Working For Families payments (an income supplementation scheme), to compensate for the GST increase.
- Resident Withholding Tax on bank interest will be aligned with the new rates.

INBOUND INVESTMENT

The New Zealand thin capitalisation rules are conventional. They limit the interest deductions that can be claimed by New Zealand taxpayers who are owned or controlled by non-residents, where they are excessively debt funded to reduce New Zealand income tax payable. The rules apply if the New Zealand group debt percentage (essentially a ratio of debt to assets) exceeds 75% and also exceeds 110% of the worldwide group debt percentage.

The "safe harbour" threshold from which interest deductions are denied will reduce from a debt to asset ratio for the New Zealand group of 75% to a new debt to asset ratio of 60% from the 2011/12 income year. The 110% threshold remains unchanged.

GST

GST increases from 12.5% to 15% from 1 October 2010. The change to the GST rate is intended to be more than compensated for by changes to personal income tax rates and support for beneficiaries, superannuitants and low income earners. Accordingly, the Government has sought to alter the tax mix by collecting more tax from consumption, rather than from income taxes.

New Zealand's GST legislation, as a general rule, focuses on the GST rate at the time the supply is treated as occurring for GST purposes. The rate at this time would apply. Legislation also provides for amounts payable to be automatically adjusted to take into account an increase in the GST rate.

PROPERTY INVESTMENT

Buildings with an estimated useful life of 50 years or more (e.g. rental properties, commercial office buildings and most non-temporary buildings) are no longer depreciable from the 2011/12 income year. This will accelerate the year in which rental properties become income producing. Depreciation loading of 20% on new assets has also been scrapped for those acquired after 20 May, 2010. The Government no longer favours this targeted incentive to invest in new assets.

Qualifying Companies and Loss Attributing Qualifying Companies (companies operating substantially as "pass through" entities) will be taxed like limited partnerships from 1 April 2011. Shareholders will be taxed on their share of a LAQC's income at their own tax rates, whereas currently only tax losses could be accessed at shareholder tax rates.

Under the limited partnership rules, access to tax losses is effectively limited for limited partners to the amount the partner has invested or has "at risk" in the limited partnership. This measure is aimed at reducing the flow through of tax losses on negatively geared rental properties.

INCOME SPLITTING - ANTI-AVOIDANCE MEASURES

The Government is aiming to end the tax advantages of structuring businesses through trading trusts or companies held by trusts by aligning the top personal tax rate and trustee rate at 33%, and excluding certain investment losses in calculating eligibility for Working For Families.

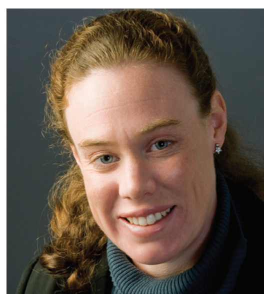
These structures had been the subject of an increasing number of cases brought by New Zealand's Inland Revenue Department which claimed that using these structures for "income splitting", to avoid the 38% top marginal tax rate or to increase Working For Families tax credit entitlements, amounted to tax avoidance.

Obviously there are still considerable asset protection and estate planning benefits for using trust structures in New Zealand and income tax levels can still be reduced by distributing income to trust beneficiaries who are subject to the lower personal tax rates.

TAXATION TEAM







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