Budget 2010

1. Introduction

As expected the Budget introduced cuts in personal income tax rates and an increase in GST from 12.5% to 15%.

Benefit payments including New Zealand Superannuation and Working for Families will increase to compensate for the increase in GST.

These changes will take effect from 1 October 2010.

The top tax rate for PIE's and other savings vehicles falls to 28%, and the rules relating to taxation of investment property are tightened.

In a surprise move, the rate of company tax reduces from 30% to 28% from 1 April 2011.

The Budget was intended to encourage savings relative to consumption and to broaden the tax base.

2. Personal tax rates

The table below shows the effect of the changes in personal income tax:

Income	Current rates	New rates
Up to $14,000	12.5%	10.5%
$14,001-$48,000	21.0%	17.5%
$48,001-$70,000	33.0%	30.0%
Over $70,000	38.0%	33.0%

While the reduction in the top rate of tax had been well signalled, reductions in the other rates were a slight surprise.

Much of the debate around personal rates has been framed in comparison with Australia.

Currently, New Zealand's income tax is higher that Australia's for individuals with incomes up to around $200,000. Under the new tax regime the crossover point falls to around $43,000, a significant reduction, although the comparison is somewhat simplistic as it ignores the effect of other taxes.

The comparative figures allow for the impact of ACC (in New Zealand) and Medicare (in Australia).

3. Superannuation scheme tax changes

There are changes to both the rates at which superannuation schemes pay tax on their investment returns and also to the Employer Superannuation Contribution Tax regime ("ESCT").

PIE investor tax rates change as follows from 1 October 2010:

Old rate	New rate
12.5%	10.5%
21.0%	17.5%
30.0%	28.0%

The tax rate on investment returns for a superannuation scheme which is not a PIE becomes 28% from 1 April 2011.

The rates of ESCT will change as follows from 1 October 2010:

Taxable earnings plus gross employer contribution	Old rate	New Rate
Up to $16,800	12.5%	10.5%
$16,801 to $57,600	21.0%	17.5%
$57,600 to $84,000	33.0%	30.0%
Over $84,000	33.0%	33.0%

The change in ESCT rates means that the gap between the top marginal income rate of 38% and the ESCT rate of 33% will disappear, as both top rates will be 33%. Hence the 5% advantage available through salary sacrifice arrangements is removed.

Accordingly, Fund Withdrawal Tax ("FWT"), which was introduced to prevent avoidance of the top personal rate by the passing of income through a superannuation scheme, will not be needed in respect of contributions made after 1 October 2010.

However, FWT has not been removed entirely – transition rules have been put in place so that payments up until 2015 may attract FWT. Unfortunately, this adds another layer of complexity to scheme administration.

4. Property income

Changes to the treatment of property investments have been expected since the Tax Working Group reported back earlier this year.

However, the measures included in the Budget are relatively mild compared to some ideas that have been discussed publicly over the past few months.

The ability to claim depreciation on buildings with an estimated useful life of 50 or more years will be removed from 1 April 2011.

Also taking effect from 1 April 2011 are changes to the treatment of Loss Attributing Qualifying Companies ("LAQC's"), such that both profits and losses flow through from them. This change is intended to reduce the opportunity for tax structuring using LAQC's.

The Budget also removes the 20% depreciation loading on new plant and equipment purchased after Budget day.

It also removes the ability for people to use rental losses to inflate their Working For Families entitlements from 1 April 2011.

5. GST

The rate of GST will increase from 12.5% to 15% with effect from 1 October 2010. This was one of the recommendations of the Tax Working Group.

This is expected to add around 2% to CPI this year.

6. New Zealand Superannuation

There are effectively two increases to New Zealand Superannuation. The first is due to the reduction in income tax rates – New Zealand Superannuation is based on a percentage of the average after-tax wage, so when tax cuts are introduced, it flows through to higher New Zealand Superannuation payments.

In addition, a 2.02% increase has been announced to compensate for the increase in GST.

The combined impact is that a married couple will receive an increase of 4.4% in their payments.

7. Company tax

In a surprise move, the rate of company tax is to be reduced from 30% to 28% with effect from 1 April 2011. Australia recently announced its intention to reduce the company tax rate from the current 30% to 29% in 2013-14 and to 28% in 2014-15.

8. Summary

Overall we view the Budget as positive for superannuation schemes and for the savings industry in general. One of the stated Budget intentions was to encourage savings and the combination of higher GST, lower income tax and lower tax on investment earnings in savings vehicles certainly improves the savings landscape.

However, the "grandfathering" of FWT is an unwelcome extra layer of complexity for scheme administrators.

The changes to property investment are intended to make financial assets more attractive relative to property for investors and hence to go some way towards correcting the perceived low level of financial assets held by New Zealanders.

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