

TAX BULLETIN

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NEW ZEALAND 2010 BUDGET – IMPORTANT TAX CHANGES

The New Zealand Government has recently handed down its 2010 Budget and it contains some important tax changes. This bulletin discusses the most significant tax changes, which can be summarised as follows:

- Personal income tax rates will be cut from 1 October 2010.
- The company tax rate will reduce from 30% to 28% from the start of the 2012 income year (i.e. from 1 April 2011).
- The GST will increase from 12.5% to 15% from 1 October 2010.

Personal income tax rates

Personal income tax rates will be cut from 1 October 2010 as follows:

| Income thresholds | Current Rates | New Rates |
|---------------------|---------------|-----------|
| \$0 - \$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% |

The above tax cuts are expected to cost the New Zealand government approximately NZ\$14.3 billion over a four year period.

Company tax rate

The company tax rate will reduce from 30% to 28% from the start of the 2012 income year (i.e. from 1 April 2011). Perhaps not surprisingly, this is in line with the recently announced reduction in the Australian company tax rate, but there is a difference in the timing. For small companies, the decrease in the Australian rate will not kick in until 1 July 2012. For other companies, the Australian rate will only decrease to 29% from 1 July 2013 and then to 28% from 1 July 2014.

Increase in GST rate

From 1 October 2010, the GST rate in New Zealand will increase to 15% from the current rate of 12.5%. However, in an attempt to make the budget revenue neutral, this increase in the GST rate is offset by a range of tax cuts, which includes the reduction in company and personal income tax rates.

This increase in the GST rate can impact businesses in various ways. Entities that have business operations in New Zealand or that simply transact with New Zealand customers or suppliers should be aware of the potential impact of the change either directly for their own operations or indirectly through their customers or suppliers. We have set out below a number of issues that will affect most businesses when the GST rate increases.

Businesses now have only 4 months to consider these issues and implement the necessary changes to their operations.



Can the rate increase be passed on to customers?

If the pricing is on a “plus GST” basis, the supplier will be able to increase its prices to account for the increase in the GST rate. On the other hand, if the pricing is stated as “inclusive of GST”, the supplier may have to bear the cost of the rate increase. If the contract is silent on the issue of a rate increase, the New Zealand GST Act gives a limited right to gross up the price to account for the rate increase, subject to certain conditions.

System adjustments

As GST is a transaction based tax, the integrity and flexibility of an entity’s accounting system is critical to ensuring that transactions are correctly captured, classified and reported.

If a system is coded with a single GST rate, set at either 12.5% or 15%, and does not have the necessary flexibility to allow for a different rate to apply to transactions, a significant amount of manual intervention may be required to ensure that the correct GST classification of a transaction is achieved. This will be particularly important in the context of transactions that span the period before and after the rate increase becomes effective. Ensuring transactions are attributed with the correct GST rate will be critical to ensuring proper compliance. This issue will be relevant for any number of transactions ranging from progressive supplies such as under a lease, to credit notes that are issued after the rate increase, but which relate to sales made before the rate increase.

Conversely, a system may allow a user to increase the GST rate applicable to transactions but may apply the higher rate to all transactions in the accounting system, including historical transactions. Under such a scenario the increased GST rate is likely to distort historical data and produce misleading accounting information for the users.

Against this background, businesses will need to understand the inherent flexibility, limitations and /or risks present in their systems. It is expected that during the transitional period, many businesses will need to manually review or recalculate their GST liability and input tax credits to ensure the correct amount of GST is being accounted for. This of itself will result in higher costs in connection with the preparation of GST returns and to ensure GST compliance generally.

Pricing issues

Subject to transitional issues, the increase in the GST rate is expected to be passed on to customers and therefore be reflected in increased prices. Businesses will need to analyse the impact of price increases on their products and services and importantly factor the increase into any long term contracts that may span the period after the rate increase takes effect. For those industries or taxpayers that do not qualify to claim input tax deductions, the higher GST rate will mean increased costs and an incentive to review and monitor their cost structures.

While the pricing of goods and services is relevant for entities located in New Zealand, it is equally as important for entities that import goods into New Zealand and that may have the liability to pay the GST applicable at the time of importation.

Importations

Businesses that import goods into New Zealand and are currently registered for the deferred payment scheme will need to review their allowed credit limit and, if necessary, apply for an increase in the credit limit to cater for the increase in GST payable at the time of importation.

Carrying cost and benefits

The GST rate increase will also have an impact on businesses' carrying costs. Businesses that are generally in a refund position will potentially be worse off following the increase in the GST rate as, all things being equal, the business will have more cash tied up in GST payments until input tax credits are refunded. On the other hand, businesses that are generally in a GST payable position will benefit from rate increase as the business collects more GST and could earn interest on the additional funds prior to the payment of their GST liability.

Industry specific impact

The points noted above reflect the issues that will be faced by taxpayers generally. A variety of issues will arise on an industry specific basis. It is imperative that taxpayers understand the potential impact for their industry and take a proactive approach to ensuring the rate increase is managed effectively.

FURTHER INFORMATION

Please ask your regular Pitcher Partners tax contact or Craig Whatman on (03) 8610 5617 for further details on the issues raised in this Tax Bulletin.

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