DowseMurray
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Newsletter

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Introduction

Important: The first provisional tax payment for 2008 is due on Saturday 7 July.

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Provisional Tax Due

The first instalment of 2008 provisional tax is due on Saturday 7 July 2007.

Make sure you make payment by the Friday to ensure your payment is recognised as being on time. Otherwise IRD will charge penalties at 1% for the first day late and this is increased to 5% of the unpaid or underpaid amount by the end of the first week overdue. Remember too that interest may also be charged at 14.6% on any underpayment.

So how much provisional tax will you have to pay?

If your 2007 tax return has already been completed then we will have sent you a schedule setting out your provisional tax payments for 2007/8.

If your 2007 tax return hasn't yet been filed with IRD then this part's for you. If your income for the year that hasn't already had PAYE or withholding tax deducted is likely to be less than $112,000 then you can calculate your provisional tax for 7 July at 110% of your 2006 residual income tax, and pay a third of that amount. Your residual income tax is basically the tax you had to pay last year on your self-employed or shareholder employee income.

So, for example if your residual income tax for 2006 was $14,000 then provisional tax for 2007/8 would be $15,400 (ie 110% of $14,000) and the payment on 7 July would be $5,133.33. Remember to pay on time or you may be charged penalties and interest.

If your tax from self-employment or as a shareholder employee in any one year is more than $35,000 (this is income of around $112,000) then you will have to estimate your tax for the year and pay a third of that estimated tax by 7 July.

While your income for the year may be very difficult to predict at the beginning of the year we would recommend that you take the worst case scenario and pay on that basis. While this may mean paying more on 7 July than you think may be necessary you can always underpay the final instalment on 7 March when you have a much better idea of your income for the year if you have paid too much.

Kiwi Saver Update

Kiwi Saver starts on 1 July 2007. This is appropriate for new, young employees the opt –out provision as the provisions will encourage saving.

Changes to the scheme have been announced as recently as last month but more information is now available on IRD's website.

There is also a range of new providers including most major banks and Gareth Morgan Kiwisaver.

Changes to Rental Property Deductions

The Minister of Finance has announced a review of the losses being made by rental property owners as a way to take some of the heat out of the housing market. The proposals include ring fencing losses so that any loss made on a property can not be offset against other income. Specifically the loss would only be offset against future profits from the same property.

This will really only have a major impact on those who have bought investment properties in the last few years and who are largely negatively geared. While rental property returns are often sitting around 5% for domestic properties and interest rates are around 9% there is a real loss before taking into account rates, insurance and maintenance costs.

This loss is often offset against the owner's other salaried or business income whether in their own name or through an LAQC (loss attributing qualifying company) and the resulting tax refund helps to offset the cash outflow during the year.

Ring fencing the losses will mean that the losses can't be offset against other properties that are making a profit or against salaried or other business income. The lack of tax refund to help offset the cash outflows is expected to provide a disincentive to invest in rental properties and this is expected to help drive down interest rates.

There are only a small number of investors who have entered the market in recent years and become heavily negatively geared. The majority of investors ensure that their properties cover the cash outgoings although this is now almost impossible in the current environment if the whole of the purchase price is borrowed.

If the losses from claiming depreciation are ring fenced then they will just carry forward and be offset against the depreciation recovery incurred when the property is sold.

One way investors will get around any ring fencing issues, particularly if they have properties making a profit, is to refinance their loans and spread them across the properties to ensure that effectively there are no losses to carry forward.

Proposals to ring fence the losses is another attempt to reduce investment in rental properties. Changes to depreciation rates a couple of years ago were expected to reduce depreciation claims but the impact of the changes have been much less than expected.

It is likely too that when an analysis is performed on the impact these proposed changes will make on investor activity it will show that there won't be a large number of property investors affected. Any ring fencing policy should also be applied to other investment types such as return on shares.

If investors buy property when interest rates are higher than returns then the only reason they will do so if for the expected capital gain. Therefore the only fair way to treat these actions is to tax the gain. But the policy should be applied to all other investment types or investors will just move investment type.

The proposal appears to single out property investors. Maybe just airing the proposal may put off some potential property investors. However, like shares, property provides a mix of income and capital gain and will continue to be a viable investment option if the figures stack up.

Associated persons

IRD has issued a discussion document around widening the definition of associated persons.

If approved, the wider definition will make if difficult for property investors to use other entities to conduct their property trading and development activities.

At present such investors tend to own their rental properties in companies such as LAQCs and operate their trading and development activities through a trading trust with a corporate trustee.

The proposed changes will see these transactions being conducted by associated persons and tax would be paid on any capital gains from rental properties, not just the properties bought specifically for sale.

Submissions on the proposed changes closed on 11 May but the outcome is not yet known.

Budget Update – Company Tax rate

It was announced in the Budget on 17 May that the company tax rate is to reduce from 33% to 30% from 1 April 2008. The company tax rate is a flat rate.

The reduction will encourage business owners to write off as many expenses that they would normally personally pay for against the business.

The highest marginal tax rate remains at 39% for individuals.

Budget Update – Change to charitable donations

In the past small companies could not deduct charitable donations, larger companies were restricted to a limit of 5% of income and individuals could only claim donations to a maximum of $1,890.

The new measures announced in the Budget allow any of these entities to claim donations to a maximum of their income. This is expected to encourage an increase in charitable donations.

The introduction of the Charities Act at the same time means that eligible charities will need to be registered with the Charities Commission which may take some currently available charities out of the net.

Contact details:

Please remember that the information in this newsletter is of a general nature only. For advice relevant to your situation please contact us.
I will be away from 27 June until 28 July but will be available by email.

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