

New developments

Company tax rate change

The company tax rate has been reduced from 33% to 30%, with effect from the beginning of the 2008/2009 income year (ie 1 April 2008 for companies with standard balance dates).

The 30% tax rate will also apply to certain savings vehicles, including unit trusts, widely-held superannuation funds, some group investment funds and life insurance policyholder funds. The top rate for portfolio investment entities (PIEs) will also be capped at 30%.

The reduced company tax rate results in the imputation credit ratio changing to 30/70 where New Zealand resident companies pay dividends to shareholders. However, the current imputation ratio of 33/67 is available until 31 March 2010 for the distribution of profits taxed at 33%.

Research and development tax credit

Legislation enacted in December 2007 introduces a new 15% tax credit for qualifying research and development (R&D) expenditure.

The tax credit is a cash credit of 15 cents for each eligible R&D dollar spent. The tax credit will be offset against the tax liability of the business or refunded in cash where the business is an exempt taxpayer or in a loss position. There is no cap on the level of tax credits claimed except in relation to internal software development. A minimum R&D expenditure threshold of \$20,000 applies, except where the R&D is outsourced to a listed research provider.

To qualify for the tax credit a business must be an eligible business, undertake eligible R&D activities and incur eligible R&D expenditure.

The tax credit will be administered by the Inland Revenue Department and will be claimed in the annual income tax return. The tax credit applies from the beginning of a business's 2008/2009 income year.

Charitable donations

Legislation enacted in December 2007 introduces significantly greater incentives for charitable giving. The effect of the changes is that:

- an individual can claim a tax credit equal to 33 1/3% of all donations made to charities, up to their taxable income;
- a company may deduct all donations to charities, up to its net income (calculated prior to taking the deduction for the donation); and

- close companies (companies 50% owned by five or fewer natural person shareholders) are now entitled to claim deductions for charitable donations in the same way as ordinary companies (non-close companies).

The changes apply to the 2008/2009 and later income years.

Partnerships

Legislation enacted in March 2008 introduces a new limited partnership vehicle to replace the current special partnership regime and clarifies the tax rules that apply to all partnerships including general partnerships.

Limited partnerships are a form of partnership involving general partners, who are liable for all the debts and liabilities of the partnership, and limited partners, whose liability is limited by their contribution to the partnership. Limited partnerships will have both separate legal status and flow through tax treatment.

The legislation contains an anti-streaming rule for both general and limited partnerships to ensure that income, tax credits, rebates, gains, expenditure and losses from a particular source or of a particular nature are allocated to partners in the same proportion as each partner's share in the income of the partnership.

Loss limitation rules ensure that losses claimed by a limited partner reflect the level of that partner's economic loss (ie limiting any tax loss claimed by a limited partner to the amount that the limited partner has at risk in the partnership).

In relation to limited partners, the tax provisions apply from 1 April 2008. In all other cases (i.e. for general partnerships and for general partners of limited partnerships) the tax provisions apply to income years commencing on or after 1 April 2008.

International tax rules review

The Government is carrying out a comprehensive review of the international tax regime. Officials released papers in 2007 providing further detail of the proposed reform of the rules governing the taxation of offshore non-portfolio investments (holdings of greater than 10% in foreign companies).

The key proposal is the introduction of an active income exemption for controlled foreign companies (CFCs). However, a number of other issues are considered in the papers, including:

- replacing the grey list exemption in the CFC rules with an active business exemption;
- allowing taxpayers with an interest in a CFC that satisfy the active business test not to attribute income under the CFC rules. A CFC will meet the active business test if its "passive income" is less than 5% of total gross income;
- allowing a CFC that fails the active business test to attribute only passive income under the CFC rules;

- amending the thin capitalisation rules so that they apply to both foreign owned companies and locally owned companies with offshore investments;
- exempting ordinary dividends (dividends that qualify for an underlying foreign tax credit under current rules) derived by New Zealand companies from CFCs and non-portfolio foreign investment fund (FIF) investments from New Zealand income tax; and
- abolishing the conduit tax relief regime.

CFC net losses and foreign tax credits accrued under the current rules will continue to be carried forward without restriction. However, transitional rules will require these losses and tax credits to be reduced by reference to total CFC net income.

The new rules are expected to be included in a bill to be introduced into Parliament in 2008 and are likely to apply to the 2009/2010 and subsequent income years.

The treatment of non-portfolio FIF interests will be reviewed once the structure of the new CFC rules has been confirmed.

Australia-New Zealand double tax treaty

The Government has commenced negotiating a revised double tax agreement (DTA) with Australia. The negotiation is expected to review all matters covered by the DTA, including withholding tax rates on dividends, interest and royalties.

Life insurance tax reform

The Government is carrying out a comprehensive review of the taxation of life insurance.

The review suggests a new model for taxing life insurance products that would tax life insurers on their net income reported in accordance with International Financial Reporting Standards (IFRS) and incorporate aspects of the portfolio investment entity (PIE) rules. Life insurance companies will be taxed on their profits in the same way as other businesses.

A five year transition period is likely to be introduced for term insurance products sold before 1 April 2009, allowing profits to be taxed under the present rules for up to five income years. The new rules would apply fully to policies taken out from 1 April 2009.

The final proposals are expected to be included in a tax Bill to be introduced in either 2008 or 2009.

Petroleum mining

A review of the petroleum mining expenditure tax rules commenced in late 2007.

Legislative changes will be made to ensure that expenditure on petroleum mining operations undertaken through a foreign branch cannot be offset against petroleum mining income from New Zealand.

The changes will be included in a mid 2008 taxation bill and, once enacted, will be effective from 4 March 2008. Expenditure incurred before 4 March 2008 will not be affected by the changes.

Climate change

The *Climate Change (Emissions Trading and Renewable Preference) Bill*, introduced in December 2007, establishes the New Zealand Emissions Trading Scheme.

Participants in the scheme will be able to trade emissions units, within New Zealand and internationally, to cover their expected future emissions obligations.

The Bill also contains provisions relating to the tax treatment of businesses and particularly the forestry sector under the scheme.

Stapled securities

On 28 February 2008 the Government announced legislative changes in relation to certain types of stapled securities. Under the new rules stapled securities will be treated as equity for tax purposes – meaning that no deductions for interest payments will be available. The changes will be included in the mid-2008 taxation bill and, once enacted, will be effective from the date of the announcement.

Relocation costs

A Government Issues Paper released in November 2007 proposes to treat most payments made by employers in relation to employee relocation expenses and overtime meal allowances as tax free in the hands of the employees who receive them.

The new rules will be included in the mid-2008 tax bill. Once enacted, the proposals are likely to apply retrospectively from the 2002/2003 income year.

Redundancy

Individuals who receive redundancy payments on or after 1 December 2006 are entitled to a rebate of 6 cents per dollar of redundancy payment, to a maximum of \$3,600 (ie the rebate is capped at \$3,600 for redundancy payments of \$60,000 or more).

Compliance costs

A Government Discussion Document released in December 2007 outlines a number of proposals to reduce tax compliance costs particularly for small and medium-sized enterprises. The proposed changes fall into two broad categories – raising tax thresholds and other simplification measures. The changes are designed to increase the productivity and competitiveness of businesses.

The proposals relating to thresholds are expected to be included in the tax bill to be introduced in mid-2008. Other proposals are likely to be included in a tax bill introduced in 2009.