

INVESTMENT TAX



The recent change to the New Zealand tax treatment of investments increases the complexity of managing tax affairs, especially when a range of investment channels are utilised. The key components are discussed below.

1. Share investments

International shares & unit trusts – directly held

The changes in tax laws for international share investments (which includes most Australian unit trusts) results in the removal of the existing grey list rules thereby effectively eliminating tax free capital gains.

The introduction of a new taxation regime for offshore investments introduced a new taxation methodology for offshore share investments (excluding directly held NZX & ASX shares) called the **Fair Dividend Rate (FDR)** method.

Under the FDR regime, investors with total overseas share portfolios over \$50,000 will pay tax at their marginal tax rate on deemed income calculated up to a maximum of 5% of the opening market value of the overseas share portfolio at the start of the tax year. If an investor's total return is less than 5% they will pay tax on the lower return. There are specific rules relating to 'quick sales' of assets purchased and sold within the same income year.

The **Comparative Value (CV)** method is an alternative available for calculating taxable income based on the market movement adjusted for dividends received during the year.

A taxpayer can choose between each method in any income year to calculate their tax liability.

International shares & unit trusts – held in a Portfolio Investment Entity (PIE)

Managed funds set up with a special **Portfolio Investment Entity (PIE)** status from 1 October 2007 will also adopt the FDR method, however, the difference is that the fund calculates and settles this tax obligation for the unit holder within the fund. Managed funds will pay tax on 5% of the average market value of the overseas share portfolio, regardless of the return from capital gains or dividends for the tax year. Simulated back testing of the effect of this tax referencing historical returns indicates that investors holding offshore investments via a PIE will incur higher total tax than if they hold these investments directly.

Australian and New Zealand listed shares

ASX and NZX listed shares held directly, including those held via a custodial wrap service will derive assessable income based on dividend distributions.

A **Portfolio Investment Entity (PIE)** will carry special tax status to exclude capital gains derived from Australian and NZ shares. Tax will continue to be paid on dividend income, as it is at present. As noted above, a government policy objective of the new PIE regime is to simplify tax compliance for the individual investor by shifting this burden to the fund manager so that tax is remitted for each unit holder by the fund itself.

Therefore, from 1 October 2007, income will flow through the PIE and investors in PIE will have their share of the taxable investment income taxed at their Prescribed Investor Rate (PIR). A PIR is similar to an individual's marginal tax rate, with the key difference being that the top rate for a PIR is 33% (from 1 April 2008, this reduces to 30%).

The 33% tax rate cap clearly provides some structuring advantages for investors on the top personal tax rate of 39%.

2. Fixed Income investments

Fixed income securities such as NZ and overseas bonds that are hedged back to the NZ dollar are taxed on their distributions.