Nobilo & Co. Ltd

Chartered Accountants

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NZ BUDGET 2011

Budget Overview

- The 2011 Budget focused heavily on cost-cutting measures to establish a path for a return to surpluses and make some significant programmes more affordable over the longer term.
- The deficit will reach a record $16.7 billion this year (8.4% of GDP), due to a revenue shortfall and some significant up-front costs. Expense-reduction initiatives should bring the budget back into surplus by 2015.
- The Christchurch earthquake is estimated to cost the crown $8.8 billion, $3.3bn to ACC and EQC and an estimated $5.5bn allocated to CERF for all other costs. To partly help funding, the Govt will launch a new Canterbury Earthquake Recovery Bond. They will have a four-year term, pay interest based on wholesale Govt Bond rates with the initial interest rate set at 4% pa.
- Health and education will have new operating expenditure of $4bn, less savings from other areas of $5.2bn, leaving a net saving of $1.2bn.
- Changes to WFF tax credits, Student Loans and Kiwisaver will produce $5bn of savings. These changes will not be made until after the November 2011 election.
- State sector savings and partial State asset sell-offs should produce further available capital. From 2012 a Mixed Ownership Model (MOM) will be applied to some State assets. The Govt's stake in Air NZ will be reduced.
- Taxation changes mainly focus on tax compliance and tax system integrity. These include:
    - An increase in the minimum level of non-deductible capital for banks under the in-bound thin capitalisation rules (from 4% to 6%)
    - An extension of the definition of income for WFF purposes to include more fringe benefits provided to employees
    - Possible taxation of salary exchanged by employees for non-taxable, non-cash benefits
    - A review of the tax treatment of assets which are used for partly business and partly private purposes, and
    - Alterations to the current option which allows farmers to switch between livestock valuation methods.

<u>Kiwisaver</u>

The default and minimum rate of member contributions will increase from 2% to 3% from 1 April 2013. Employees will retain the option to opt out.

The rate of employer contributions will also increase from 2% to 3% from 1 April 2013.

The member tax credit will be reduced to 50 cents per dollar of individual contribution with the cap halved to $521 per year from the year ending 30 June 2012. This change will be reflected in payments to Kiwisaver accounts from the second half of 2012.

The exemption from the Employer Superannuation Contribution Tax will be scrapped from 1 April 2012. This exemption is regressive, in that those on higher incomes receive larger subsidies. (This now means the net employer contribution in many cases will hardly increase at all).

Existing kick-start payments will remain unchanged.

The combined effect of cutting the MTC (member tax credit) and imposing ESCT on the employer contribution is expected to save the Govt $2.6bn over the next four years.

Working for Families

Working for Families will remain essentially in its current form. The changes consist of small adjustments to the abatement threshold and abatement rate, and a gradual alignment of the over-16 rate with the 13-to-15-year-old rate.

These changes will be phased in over four steps as Family Tax Credit rates are adjusted for inflation. This is a very gradual transition which is expected, given current inflation forecasts, to take eight years.

Lower-income families and beneficiaries will be largely unaffected by these changes, and the majority will actually get an increase in their Working For Families payments after 1 April next year. A number of families higher up the Working for Families scale, however, will receive a little less than they currently do now, or will no longer qualify. In most cases, the impacts will be small.

The changes to the WFF scheme must be considered in conjunction with the significantly widened concept of "family income" which came into effect from 1 April 2011. For WFF a person's income may include trust income (if the person is a settlor of the trust) and income of companies controlled by such trusts, along with attributable types of fringe benefit from a company controlled by the person. These changes, more than the abatement thresholds, will impact most on the ability of the more well-off to access the WFF regime.

The Tax System

The final elements of last year's tax package have now come into force, including tighter income definitions related to State assistance and reducing the company tax rate to 28 per cent.

This low rate of tax on businesses demonstrates that we are prepared to back them and recognise that business is the growth engine in a modern economy.

The Budget contains no major taxation initiatives and essentially only notes the taxation changes which have already been put in place.

The tax changes announced in Budget 2010 are now largely in effect, the biggest tax reform seen in New Zealand in 25 years.

The budget notes.. a desirable medium-term goal of reducing and aligning personal, trust and company tax rates at a maximum rate of 30% as favoured by United Future (and included in the confidence and supply agreement with ACT).

The proposal to enact income-splitting and it's likely implications is also on the Govt radar. The $500 million fiscal cost of the package needs to be addressed before the proposal proceeds.

A further tax policy work programme is scheduled to be released shortly. The following topics are already under consideration:

- The tax treatment of profit distribution plans.
- The tax treatment of charitable giving.
- The imputation system.

- The tax treatment of employee benefits.
- Amortisation of capital raising costs.
- The international tax review.
- The GST treatment of cross-border business activities, and
- The tax treatment of hybrid instruments.

And perhaps the tax treatment of employee benefits paid in lieu of salary.

ACC

Over the past two years, ACC has successfully controlled its previously run-away costs, and delivered better results from existing spending.

One immediate benefit is that the Govt will need to contribute $638 million less to the non-earners account over the next four years than previously projected.

ACC members in other accounts will also benefit, with future levies also trending lower as a result of the cost savings within the scheme.

STUDENT LOANS

This year the crown will lend almost $1.6billion to assist students, up 50 per cent over the past five years. There are currently more than $12 billion of loans outstanding.

However, at present, for every dollar lent out the Govt receives only around 55 cents back in 2011 dollar terms.

Budget 2011 tightens the lending criteria so that the scheme is better focussed on those who really need assistance.

Key changes include:

- Restricting student loan eligibility for those with an overdue repayment obligation of $500 or more who are in default for more than one year.
- Restricting borrowing for people aged 55 years and over to tuition fees only.
- Removing the entitlement for part-time, full-year students to borrow for course-related costs.
- Holding the repayment threshold at 419,084 until 1 April 2015 rather than inflation-indexing this amount, and
- Shortening the repayment holiday for overseas-based borrowers from 3 years to 1 year, and requiring borrowers to apply for the repayment holiday and provide a NZ-based contact person before they go overseas.