

BC'S BUSINESS BRIEFS

ECONOMIC UPDATE

Each of the Business Briefs prepared to date has included an opening section which included the writers thoughts and predictions on a range of topical issues. As often as not the writer has ended up with egg on the face, but here we go with another round and a summary of some that may have had an element of reality to them. (If you make enough predictions there must be a chance that some will come to fruition!)

The ones that look like they came close to fruition in hindsight!

- 1 We will see the government move into election mode with further spending promises;
- 2 We will continue to lose manufacturers as they relocate to cheaper economies in Asia;
- 3 The government will continue to accumulate surpluses and Dr Cullen will move closer to the opposition as regards tax cuts 2 years out.
- 4 Company Tax rates will drop to 30% with a consequent reduction in the top personal rate.
- 5 The NZ currency is currently overvalued and when a correction downward occurs, it could happen quickly.
- 6 We will see a continuing push to make changes in the way the world lives to slow down climate change which will have potentially far reaching economic impact;

Now a few new predictions!

- 1 The fallout in the US economy from the mortgage crisis will continue which in itself will lead to an easing in oil prices because of the reduced demand for oil, but not to a level that it was 12 months ago;
- 2 One of the big 3 American car companies will hit serious financial difficulties as a result of their inability to alter production quickly enough away from the large SUV market to the compact cars which will rapidly dominate the American market. The large Japanese manufacturers will grow in size rapidly as their compact car expertise will increase their share of the world markets;
- 3 The next 12 months will see the real benefits of the increased dairy payout hit our economy with the impact of last summer's drought fading and a continuing of the realignment of New Zealand's net wealth happening delivering benefits to the rural economy, while the cities to a large degree remain stagnant until the next economic upturn occurs;
- 4 New Zealand will see a change in Government at the election later this year, although the National party will not have a large enough share of the vote to govern alone and Winston will arise from the ashes to again play kingmaker;
- 5 Despite the utterings of some bank economists, interest rates will come down later this year and are likely to stay down for at least the 2-3 years as despite the fact that inflation looks set to stay stubbornly high for at least 12 months, there is a growing realisation that while keeping interest rates high may (possibly!) cure inflation it will likely kill the patient.

Tax Changes

The new corporate tax rate began on 1 April of 30% and personal tax reductions will begin phasing in on 1 October. This phase in process will mean different rates of tax for the 2009 and 2010 tax years for all individual taxpayers and will no doubt have some taxpayers wondering about the benefits of deferring income from 2009 to 2010, as we get closer to the end of the financial year, which for some taxpayers is as early as 31 October 2008.

Changes to the "Associated Persons" test

From 1 April 2009, the sections of the Income Tax Act that deal with associated persons will be tightened up, if the 500 page Tax Bill introduced to Parliament last month makes it all the way to law in substantially the same form that it was introduced in. For taxpayers active in the area of either property dealing, developing or building, the net is going to be cast wider in terms of the associated persons who become "tainted" by the activity. The impact of this will be that many of the structures put in place in the past which had as one of their purposes to ensure that tainting did not occur unnecessarily, these structures will no longer be effective. It appears that the existing structures will retain their tax effectiveness for property acquired prior to 1 April 2009, but care will need to be taken for acquisitions after this time. We will ensure that clients likely to be affected by this change are advised accordingly when the bill is finally passed into law.

A Corporate tax rate reduction?

With the change in the corporate tax rate from 33% to 30%, most clients who have the shares in their trading companies owned by a Trust, will achieve only a deferral of the tax payable on company profits, rather than a reduction as the government would have us believe. This is because the Trustee rate of tax remains at 33% and at the time that shareholders wish to take the available profits from their companies by way of dividend, then those dividends will have a shortfall of tax paid on them by a minimum of 3%. From a practical point of view, the overall tax rate on those company profits therefore remains at 33%, rather than the promised 30%. There will also be a requirement for companies to separately identify the imputation credits available to be attached to dividends at the rate of 33% from those at 30%, until the 33% credits have been exhausted. All the rate change has therefore achieved is a deferral of tax and an increase in the compliance cost of administering the change. This sounds like a smoke and mirrors benefit to us, and politicians wonder why the general public is cynical of them.

Please feel free to contact the writer should you wish to discuss any of the contents above further.

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