

BC'S BUSINESS BRIEFS

Economics – Confusing or not?

Like many people, I subscribe to economic updates from a number of sources. Amongst these sources, I received economic reports earlier this week from two of our leading banks economists. Amongst the myriad of information from the two reports, I found the following commentaries on what each of the authors would do if they were making a decision on what to do with their house mortgages in terms of fixing the interest rate for a set term or using a floating rate.

- 1 "Personally, I would still fix three years at 6.99% because that rate is 1.1% below average and it gives me good cash flow certainty for an extended period in an environment where lots of other things are uncertain", said one author, while the second author said;
- 2 "For those borrowers currently on floating rates who have been looking to time their re-entry into fixed rates, we recommend fixing now for six months to one year, which are easily the most favourable rates on offer."

Two vastly different pieces of advice from two people who both supposedly are competent, (in fact their employers would call them experts, I would suspect) both providing their advice based on exactly the same set of facts and information available. How can two experts come up with such vastly different recommendations. Who is right? Who is wrong? Are they both right or wrong?

We all know that economics is not a precise science. It is using information readily available from many sources, interpreting that information and, in this case, making predictions of future market movements to provide meaningful advice and summaries. Could it be that both could be right? A homeowner with a fixed income that allows them to make their repayments at the 6.99% level but without too much income to spare, may well be better off by locking in for a three year term, whereas someone at a different stage of their life, such as a young couple with prospects of advancement and significant income increases in the reasonably near future may well be better off to lock in a shorter term rate if the reasonable expectation is that their income may be able to sustain larger debt servicing costs and earlier mortgage repayment in 12 months time.

The point of this discussion is that while there is a veritable mountain of information available to people, not one solution fits all. It is important to be informed, seek advice from people qualified to assist, and work through the specific facts as they relate to you. Finally the aim is to come up with a solution that you are comfortable with and works for you.

Oh, and by the way, even economists will tell you that no two economists will ever agree on what the same set of facts actually mean, in practical terms!

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Company Dividends and Tax Credits

The reduction in the company tax rate from 33% down to 30% for the 2009 Income year and beyond, has meant that there is a change in the tax credits that can be passed from companies to their shareholders on profits earned in the new tax rate environment. The maximum Imputation credit that can be passed is reduced from 49.25% of any Dividend received to 42.85%. However, the tax rules are such that Dividends when paid out must still include a tax credit of 33% of the gross dividend paid, meaning that any dividends paid from this source must be topped up by Resident Withholding Tax amounting to 3% of the gross dividend on the 20th of the month following payment. Remember, payment is deemed to include crediting to account and (as noted below) the date of the directors resolution authorising the dividend is crucial to when this liability falls due. If in doubt – check with us.

There are also transitional rules in place which allow for the payment of Dividends at the prior rates if paid prior to 31 March 2010 to allow for the utilisation of all tax paid at the 33% rate. We will be reviewing all company clients between now and 31 March 2010 to ensure that the maximum credits available are utilised.

Recent Tax cases

Three recent court decisions have significance for many business taxpayers.

- 1 In the **Trinity** case, which the IRD won, it was nevertheless acknowledged that taxpayers had the right to structure their affairs in a manner that reduced tax. While there are parameters applying to this around commerciality, the principle is important as many had wondered in recent times whether this was accepted by IRD;
- 2 The **Penny & Hooper** case, which was won by the taxpayer, established that there is no requirement for taxpayers in a company situation to pay themselves “commercial” salaries. It is very common for shareholders to pay themselves salaries that are less than those paid by an independent employer for a number of reasons, and leave the remainder of the income within the company to be taxed at the company tax rate of 30%. The IRD had sought to force “commercial” salary rates upon these taxpayers, an argument the court has rejected. However the IRD is not a good loser – the case is being appealed!
- 3 Finally in the **Albany Food Warehouse Ltd** case, the court ruled that the exact time of payment of a dividend was determined by the date/time that the Directors resolved to make payment of the dividend, regardless of when or if any money was actually paid or when the entries were put through the company accounts.

Please contact us if you require any clarification of matters raised herein.

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