



PIE Tax and PIR

Summary of the tax changes

In December 2006, the Government passed new legislation to change the way investment income from managed funds will be taxed. The Government introduced these tax changes, along with KiwiSaver, to encourage New Zealanders to save more.

The Fair Dividend Rate (FDR) changes came into effect from 1 April 2007 and the Portfolio Investment Entity (PIE) came into effect on 1 October 2007.

The key benefits of the PIE changes are:

- There is no tax on capital gains for Australasian shares. Only income generated from these investments will be taxed.
- Investors will be taxed at their individual rate, which is capped at 30% (as from 1 April 2008).

There are no changes to tax on income from direct shares or bonds as a result of the PIE changes.

Overall these changes are expected to reduce the amount of tax paid by investors in managed funds. The new rules should result in both lower taxable income and a fairer application of tax rates.

Fees related to ongoing portfolio monitoring will still be deductible under the PIE Regime. PIE income is, in most cases, excluded income, meaning it is excluded from the IR3 filing requirement and does not get assessed at tax year end but still forms part of your gross income.

What are PIEs?

Since 1 October 2007, Fund Managers have been able to elect managed funds into the Portfolio Investment Entity (or PIE) regime. Qualifying funds will be known as PIEs.

Generally, PIEs pass through income to the investor and deduct tax at the investor's individual rate called their Prescribed Investor Rate (PIR).

What can become a PIE?

The legislation prescribes a list of rules around what can qualify to be a PIE.

Only managed funds, such as Unit Trusts, Superannuation Schemes and Group Investment Funds, are eligible to elect into the PIE regime. Other investments, such as bank deposits, finance company deposits, direct shares and direct bonds, are excluded.

	Direct Investors		PIE (Managed Fund) Investors	
	Australasia	International	Australasia	International
Fixed Interest/Cash	Taxed on all income at marginal rates		Taxed on all income at PIR, which is capped at 30%	
Equities/Shares	Taxed on dividends at marginal rate. If actively traded, taxed on gains too.	Taxed at marginal rate on lesser of actual return or 5% of opening value of shares. If less than \$50,000 owned then only taxed on dividends.	Taxed on dividends at PIR. Gains not taxable even if actively traded.	Taxed at PIR on 5% of weighted daily opening portfolio value (less costs)
Overseas Funds	An investment into any overseas fund is treated like an international equity and taxed on up to 5% of opening balance regardless of actual returns or underlying assets. Will form part of the \$50,000 de minimus mentioned above.			

The NZFP Cash Fund was launched on 1 April 2008. It is a PIE version of the NZFP Cash Account and is a good option for higher tax payers as the top rate is now capped at 30%.

What do the PIE changes mean for investors?

Under the PIE regime, the treatment of capital gains, how investment income tax is calculated and how tax is calculated for managed funds changes.

What does it mean to be in a PIE?

For PIEs, the manager will calculate and store the taxable income for each investor on a daily basis according to the number of units they own.

At the end of each tax year (31 March), or on full withdrawal or full switch during the year, the fund manager will calculate the total taxable income by adding up the daily amounts. Tax will then be deducted at the investor's individual rate (known as the PIR) and paid to the Inland Revenue Department.

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For a partial withdrawal, any tax payable will be deferred until the end of the tax year. An investor must have sufficient funds to pay tax, which will be monitored by the manager.

How units are priced in a PIE?

Under the PIE regime, the way fund managers calculate the unit price changes from a "net of tax" price to a "gross of tax" price.

Non-PIE managed funds calculate a unit price after allowing for tax at 33%, ie:

Value of Investment = Net Unit Price x No. of Units

PIE funds calculate a unit price before allowing for tax, ie:

Gross Fund Value = Gross Unit Price x No. of Units

The value of the investment is then be calculated by applying an individual investor's PIR to the taxable income portion of the price.

Please note that the unit price will fluctuate in direct correlation with market movement.

Is PIE tax a final tax?

For an individual, if the correct tax rate is provided it is a final tax. If an incorrect tax rate is provided, it isn't. For companies and trusts in the 0% PIR, it is not final.

Portfolio Investor Rate (PIR) and Marginal Rates of Tax			
Marginal Rates	Taxable Income	Less than \$38,000	19.5%
		Less than \$60,000	33%
		Anything over \$60,000	39%
PIR	Taxable (non-PIE) Income AND Total Income (Including PIE)	Less than \$38,000 AND Less than \$60,000	19.5%
		Anything over these limits	30%
		PIE Income is income earned within a qualifying managed fund or Portfolio Investment Entity. Test is applied against previous 2 years income.	

Is PIE tax a withholding tax?

No. However there are some similarities. PIE income is classed as Excluded Income which means

it is excluded from the IR3 filing requirement and is not assessable income.

How are non-residents be treated?

Tax will be deducted at a flat 30% and there is no provision for supplementary dividends or foreign investor tax credits. It is unlikely that the tax jurisdiction of residence will allow a PIE tax credit.

What happens with Charities in the new regime?

Charities will no longer require separate tax exempt products as they will be able to elect a 0% tax rate for investments in a PIE provided they have a valid certificate.

Prescribed Investor Rate (PIR)

The PIR is the rate at which an investor's taxable income from PIE investments will be taxed. The accurate calculation of the PIR is critical to ensuring that investors pay the correct tax.

It is up to the investor to provide this rate, taking into account all of their income for the year. Some may require assistance with this calculation. Each year individual investors in PIE products will need to

review their PIR and confirm the rate to the fund manager.

PIR and Marginal Rates of tax can differ as shown in the table above.

Income Types

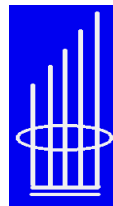
There are three key income types to understand before calculating the PIR.

1. PIE income is earned from investments made by managed funds that have become PIEs. From 31 March 2008 onwards, PIE investors will receive an annual tax statement providing their PIE income details.
2. Non-PIE income is pre-tax income from all sources except from PIE investments. The following are included in non-PIE income: Salary & Wages, Withholding Payments, New Zealand Interest, New Zealand Dividends, Maori Authority Distributions, New Zealand Estate or Trust Income, Overseas Income, Partnership Income, Shareholder employee salary, Rent, Self-employment, Other Income, Losses from a Loss Attributing Qualifying Company. Allowable expenses are deducted from the above to estimate non-PIE income. Note, capital distributions from a trust are not

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considered income for PIR estimation purposes.

3. Total income is income from all sources, including both PIE and non-PIE income (as defined above).

Selecting the right PIR?

Due to the fact that PIR's can change from year to year, clients will be required to select their PIR each year. There will be an annual mail out prompting them to do so.

If investors are 30% and elect a 19.5% tax rate, two things happen. They can provide correct rate before 31 March and adjustment will be made within the fund. If they do not update to the correct rate, all PIE income becomes assessed as other income.

If investors are 19.5% and elect a 30% tax rate, two things happen. They can provide correct rate before 31 March and adjustment will be made within the fund. If they do not update to correct rate there is no credit for over-payment of tax.

It is important to note that if a PIE investment is owned by more than one person, the highest individual PIR will apply. For example, if one owner of the investment is on a PIR of

19.5% but the other owner does not supply their PIR or has a PIR of 30%, the highest rate of 30% will apply.

Clients can opt to split their portfolios so the whole portfolio is not taxed at the highest rate of 30%. Instead, one owner has their half taxed at 19.5% and the other at 30% so overall they are paying less tax. Alternatively, they may wish to transfer the whole portfolio to the lower taxpayer's name; however they should be aware of the matrimonial property implications of this type of arrangement.

Trusts can elect a 0% or 30% tax rate. If they elect 0% it is not a final tax. This is beneficial if income is being distributed to 19.5% beneficiaries as they will pay tax at their own marginal rate. Any PIE income distributed to beneficiaries where the trust elects 0% rate, it is regarded as other income.

If trusts elect 30%, it is a final tax and they will not be able to offset monitoring fees or tax losses against their PIE income. To do so, the trust will need other income to offset these against. On 1 April, the top PIE rate dropped to 30%, while the trust non-PIE income tax rate remained at 33%.

Bare Trusts are trusts which are held on behalf of children, for example, education funds. Clients can select

either a 0% or 33% tax rate, however they can also be taxed at the lower PIR of 19.5%.

PIE tax will only be paid at the end of the tax year, or on full withdrawal or transfer. This could mean a lump of income is suddenly realised at tax year end. Trusts and beneficiaries that are provisional tax payers could be subject to "Use of Money Interest" if no provisional payment is made.

Estates are taxed in their own rights as a separate entity, and are normally eventually wound up and distributed to beneficiaries. The same treatment as for trusts would apply to estates, but caution must be taken when determining the deductibility of expenses.

The tax situation for each trust varies, so investors must seek professional tax advice to fully understand the implications of selecting either the 0% or 30% PIR.

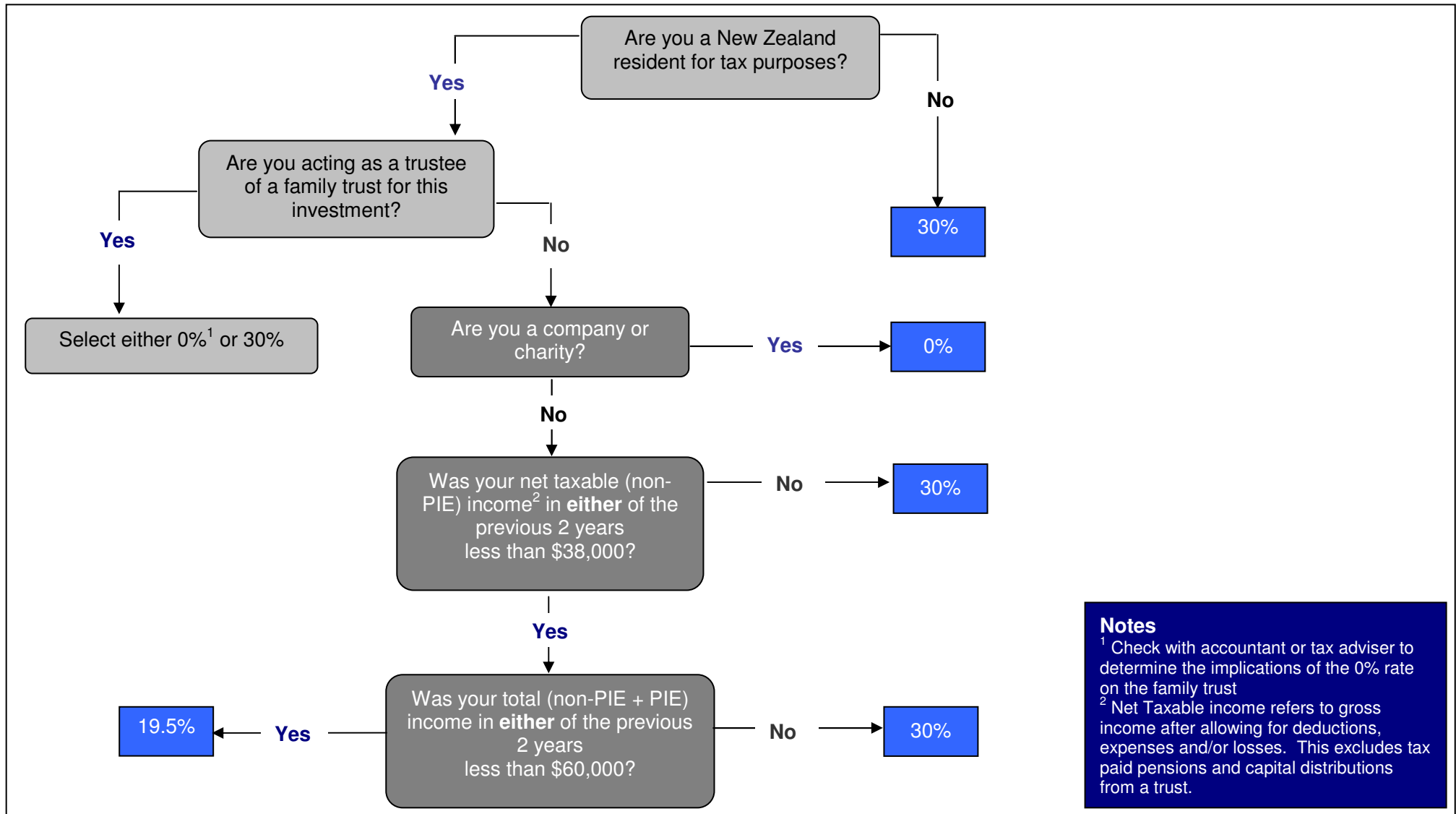
PIR is based on **either** of the previous two years income. The current year is not relevant. Investors can choose which of the two years the PIR is based on. The flow-chart overleaf provides a general guide to calculating an investor's PIR.

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Notes
¹ Check with accountant or tax adviser to determine the implications of the 0% rate on the family trust
² Net Taxable income refers to gross income after allowing for deductions, expenses and/or losses. This excludes tax paid pensions and capital distributions from a trust.

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