

Tax and Managed Funds

By Joy Scandlyn and Craig Dealey, New Zealand Financial Planning Co. Ltd



NEW ZEALAND
FINANCIAL PLANNING

The recent radical overhaul of the way investments are taxed is aimed at levelling the playing field by removing the tax disadvantage to those choosing to invest in actively managed funds. KiwiSaver was the catalyst for the changes. Overall the changes have been welcomed by the wider investment community, even if the method used to calculate the tax has not received the same level of support, mainly because it's too complex for many.

These new initiatives are something that you, in your role as a Chartered Accountant, will be working on. Like us in our financial planning role, will need to educate your clients on the changes. The new tax and the way its calculated are not straightforward. We have been acutely aware of this as we prepare material to advise our clients.

Everyone currently holding investments or thinking about investing should try to have at least a basic understanding of the changes if they want to minimise their tax. The environment for investments has potentially become more complex for DIY investors, as some people may find that their previously simple, low maintenance investments now suddenly require a lot more attention.

However, those who have their investments managed by fund managers will have the complexities of the tax changes taken care of by the fund manager's administration system. You are sure to have many clients who fit into the "increased complexity" category and they may not have even considered the implications. Now is a good time to consider income and investments as a whole. After all, why would anyone want to pay more tax than they need to?

Even people with ad hoc shares that they purchased or inherited years ago and have left untouched until now, will need to take a close look at them.

With the changes, we will also have to become familiar with new acronyms: Fair Dividend Rate (FDR), Portfolio Investment Entity (PIE) and Personal Investment Rate (PIR).

International shares will be taxed using the FDR regime and should, overall, mean clients with money in actively managed funds invested overseas will pay less tax.

For locally held investments the tax breaks are also generous. The PIE regime which comes into effect on 1 October, removes the tax on capital gains from most NZ and Australian shares – regardless of how actively a fund trades in these shares. This makes Australasian funds very attractive, tax wise. But even here, there are some traps for the unwary regarding the definition of exempt Australasian shares.

The PIE regime allows managed fund investors to be taxed at their own marginal rate as opposed to the current flat 33 percent. An additional sweetener for PIEs is the band (for those eligible to have their investments taxed at 19.5%) has been significantly widened. Furthermore, the rate has been capped at 33 percent, even for those in the top band.

Then, from next year, this capped rate is reduced to 30% in line with the drop in company tax rates. This is great news for those invested in many actively managed funds because now they can continue to benefit from the higher returns but also pay less tax. Investing in passive funds is now less attractive because the previous beneficial treatment for these funds is now available to all.

These changes mean some of the existing investment vehicles become tax effective and make other conventional ways of investing, such as direct New Zealand fixed interest, far less so.

It is important to understand how each of these new taxes affects the others. Holding the wrong investment mix may not make you worse off, but there can certainly be benefits to structuring your portfolio properly.

Altering investments to minimise tax is a good idea, but it is important that all investors consider their entire portfolio, goals, objectives and risk profile, before doing that. Minimising tax is not a strategy, nor is simply putting money into KiwiSaver or any other ad hoc investment. If Chartered Accountants or any of their clients are working with a financial adviser, discussions should be held regarding the overall tax position.

For anyone who doesn't have a financial adviser, now would be a good time to find one. There is nothing to lose and instead, an overall strategy may be planned to ensure goals are achieved and in a more tax-effective manner. It is imperative that this isn't left until the end of this tax year to find out tax has been overpaid – PIE is a final tax and that means no refunds.