Company tax rate change: questions and answers

1 Why is the company tax rate being reduced from 33 per cent to 30 per cent?

Business tax reforms are a substantial and important part of the government's economic transformation agenda. Our aim is to have a sustainable economy built on innovation and quality, producing the kinds of products for which other countries will pay a premium. The business tax reforms are intended to help foster an environment that enables New Zealand businesses to grow and compete in a global economy.

The Business Tax Review was a key feature in the government's Confidence and Supply Agreements with United Future and with New Zealand First.

Reducing the company tax rate will allow successful businesses to keep a greater share of their profits. This is expected to increase investment in New Zealand which in turn will boost productivity. It is also expected to increase profits recognised in New Zealand which in turn will lift our international competitiveness, especially with Australia.

2 Who will get the company tax rate reduction?

The tax rate reduction applies to New Zealand companies, including unit trusts.

3 Why is the rate reduction restricted to companies?

The Business Tax Review discussion document, released in July last year, consulted on the possibility of a company tax rate reduction. The Review noted that most business activity in New Zealand is undertaken by companies and acknowledged that a company rate reduction would not benefit unincorporated businesses. Submissions on the Review strongly supported a company tax rate reduction, though some also supported reducing personal tax rates at the same time.

A company tax rate reduction increases incentives to invest and improve productivity for New Zealand companies. It also improves the attractiveness of New Zealand as a location for companies, especially in relation to Australia. Therefore a reduction in the company tax rate directly addresses the two main objectives of the Business Tax Review.

Personal tax reductions are a less direct way of reducing taxes on businesses (and addressing these objectives) as business income is a relatively small share of total personal income.

4 **When does the tax rate reduction come into effect?**

Most of the amendments apply from the beginning of taxpayers' 2008/09 income years. The exceptions are:

- the amendments that relate to Qualifying Company Election Tax, which will apply from 17 May 2007; and
- the amendments that relate to benchmark dividends, which will apply from 1 October 2007.

5 **How do companies take advantage of the tax rate reduction?**

Companies calculating their tax liability should use the reduced rate from the start of their 2008/09 income year. There will be special rules for provisional taxpayers who use the uplift method to allow for the tax rate reduction.

6 **Won't the tax rate reduction be clawed back when profits are paid to shareholders?**

The imputation system allows credits for tax paid at the company level to be passed through to shareholders, offsetting their tax liability on dividends received. Following the company tax cut, to the extent that profits are distributed to New Zealand taxpaying shareholders, less tax will have been paid at the company level, requiring additional tax to be paid at the shareholder level. However, companies will benefit from the lower rate so long as profits are retained and reinvested in the company.

7 **What associated changes are being made as part of the company tax rate reduction?**

Reducing the company tax rate will require a number of associated changes. These include amendments to the imputation rules, altering the tax credit ratios for shareholders, amending the foreign investment tax credit and available subscribed capital formulas, changes to the qualifying company rules and adjusting the Branch Equivalent Tax and Conduit Relief Accounts.

8 **Why are there transitional imputation rules?**

The maximum imputation credit ratio is set equal to the company tax rate. Allowing the imputation ratio to change at the same date as the company tax rate is simple but would adversely affect many shareholders since dividends are usually paid out in arrears. Profits taxed in the company's hands at 33 per cent would be imputed only to 30 per cent, leading to an additional top-up tax being paid by shareholders.

The transitional period therefore allows for profits that have been taxed at 33 per cent to be passed through to shareholders with credit for this higher rate of tax.

The transitional period will run from the beginning of the 2008–09 income year to the end of the 2009/10 imputation year (being 31 March 2010). At the end of this period, companies will be able to distribute any 33 per cent tax credits at the new imputation ratio of 30/70.

9 Why do shareholders who are companies or widely held savings vehicles not fully benefit from the transitional imputation provisions?

That is to prevent those shareholders with a 30 per cent tax rate from being able to use the additional 3 per cent credit to shelter other income from taxation.

10 How do companies take advantage of the transitional imputation period?

Companies will need to calculate the level of their 33 per cent tax credits. To the extent that they have a balance of these credits during the transitional period they will be able to allocate them at a maximum tax credit ratio of 33/67.

11 Why is no associated change being made to the resident withholding tax (RWT) rate?

No change is currently proposed in relation to the rates of RWT on interest and dividends, as 33 per cent is a final tax for a number of shareholders, including a number of individuals who do not have to file tax returns because their income is presently fully taxed. In addition, Inland Revenue is considering carrying out an operational review of RWT.