

Budget 2011

19 May 2011

The Minister of Finance, Bill English, introduced his third budget in Parliament today. Many of the moves were foreshadowed by the Prime Minister, John Key, at the Prime Minister's address last Wednesday. The budget was clearly a no surprises budget.

As expected the huge cost resulting from the Christchurch earthquakes and AMI insurance bailout ballooned the deficit out to \$16.7 billion.

It is planned that the budget will return to surplus by 2014.

Focus will also be placed on introducing private sector disciplines to state sector assets and reducing Government spending on back room functions.

Inflation is forecast to be below 3% in two years, after the effect of the GST increase has flowed through.

The unemployment rate is projected to be below 5% next year.

The good news for homeowners and property investors is that interest rates are likely to stay lower longer.

The dream of faster broadband may become a reality with the Government planning to spend \$1 billion on creating faster broadband.

Partial state assets sales are forecast for 2012 and the acceptability of these to voters will be tested at the ballot box in the November 2011 general election.

Some of the budget highlights that affect our clients are:

KiwiSaver

- the \$1,000 Kick-Start remains
- From 1 April 2012 employer contributions to KiwiSaver and other complying superannuation funds will be subject to Employer Superannuation Contribution Tax (ESCT) paid at the employee's marginal tax rate
- For the year ending 30 June 2012 and beyond, the Government Tax Credit contribution will be halved from the current \$20 per week to \$10 per week
- From 1 April 2013 the minimum employee contribution rate will rise from 2% to 3%. This will also be the new default rate, but members will still be able to select a higher contribution rate of 4 per cent or 8 per cent
- From 1 April 2013 the compulsory employer contribution rate will also rise to 3%.

Comment:

Although the \$1,000 kick-start remains and employees will still receive a \$521 per year subsidy, the additional 1% employer contribution will increase the cost to employers.

For shareholder employees, the additional benefit of deductibility of the employer contribution disappears with the new ESCT imposed at the employee marginal tax rate.

Student Loans

Although student loans remain interest free there will be a general tightening up of the scheme by:

- Restricting borrowing for people aged 55 and over to tuition fees only
- Making students with overdue loan repayment obligations ineligible for new loans
- Removing the entitlement for part-time full-year students to borrow for course-related costs
- Holding the student loan repayment threshold at \$19,084 until 1 April 2015
- Requiring every new loan application to include a contact person as one of the conditions of accessing a student loan
- Shortening the repayment holiday for overseas-based borrowers from three years to one year, and requiring borrowers to apply for the repayment holiday and provide a New Zealand-based contact person before they go overseas
- Broadening the definition of income for student loan repayment purposes
- Extending the exemption to the two-year student loan and allowance stand-down for permanent residents and Australians to include the sponsored family members of protected persons.

Comment

Restricting student loans to tuition fees only for those over 55 could be seen as age discriminatory. The overall package of making students who take out student loans more accountable for repaying them is clearly more fiscally responsible. Keeping the loans interest free should not discourage students borrowing to become more qualified.

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Working for Families

Tougher economic times often mean more families are faced with the reality that they are eligible for, and often dependant on family support packages.

Slight adjustments have been made to the WFF regime.

As the Family Tax Credit (FTC) payments are adjusted for inflation, the WFF abatement threshold will decrease by \$477 on the first adjustment, and thereafter each time by \$450. This means eventually the WFF will have a slightly lower abatement threshold of \$35,000, compared to the current \$36,827.

A slightly higher abatement rate of 25 cents in the dollar, compared to the current 20 cents in the dollar (this means WFF payments will reduce faster as income increases). There have been adjustments to the age bands for children so the number of different FTC payment categories will reduce from five to three.

Selling the Silver

Beginning in 2012, the Government is to adopt a mixed ownership model by selling down a stake in four state-owned energy companies and reducing the Crown's majority shareholding in Air New Zealand.

Majority ownership will be maintained in Mighty River Power, Meridian, Genesis and Solid Energy. The Government's will reduce its majority stake in Air New Zealand. The planned proceeds will be between \$5 billion and \$7 billion.

Tax Moves

Working for Families income criteria to be tightened

Employee definitions of income are to be reviewed with a view to expanding the definition of income for Working for Families Tax Credit purposes. The Government is to consider whether fringe benefits provided to employees, or where salaries can be traded off for non-taxed non-cash benefits, should be included as income.

Mixed-use assets

Although no details have been made, the Government is to tighten up the tax treatment of mixed use assets where losses are claimed for tax purposes on items such as holiday homes and yachts where they are both rented out and used privately.

Livestock valuation elections

Changes are likely to be made to farmers livestock valuation elections.

Under the current rules, a farmer can switch back and forth between two methods, herd scheme or the national standard cost scheme, choosing the more favourable outcome for tax purposes. This can mean increases in market valuations go untaxed, while decreases in valuation can be eligible for tax deductions.

Thin Capitalisation for Foreign Owned Banks

The Government will change the thin capitalisation rules for foreign-owned banks, with the minimum prescribed percentage of equity for tax purposes increasing from 4 per cent to 6 per cent from 1 April 2012.

Canterbury Earthquakes

Supporting those affected by the tragic earthquakes in Canterbury by rebuilding Christchurch is a major goal of Budget 2011. Christchurch is NZ's second-largest city; a major industrial, tourism and regional hub, and is therefore essential to the performance of the wider economy (not to mention the nurturing ground for some of our greatest All Blacks).

Treasury estimates of the damage caused by the two earthquakes is around \$15 billion, which is about 8% of GDP. To put this in context, the March earthquake off the north-east coast of Japan is estimated to have caused damage equivalent to around 3% to 5% of Japan's GDP.

The Government plans to provide \$5.5 billion over six years for the Government's new Canterbury Earthquake Recovery Fund.

The Government is borrowing the bulk of that money in the short-term and is introducing a new Earthquake Kiwi Bond which will pay interest based on wholesale government bond rates, initially 4%.

The Canterbury Earthquake Recovery Fund will cover:

- The Government's share of repairing essential local infrastructure - mainly water and roading infrastructure, repairing state owned assets such as state highways, schools and hospitals.
- Welfare support through job loss cover and wage subsidies, as well as costs relating to the immediate response to the emergency
- The Government's financial support package for AMI.

Earthquake costs and funding sources:

Instrument	Canterbury Earthquake Recovery Fund		EQC + ACC
Estimated costs	\$5.5 billion		\$3.3 billion
Funding source	\$4.8 billion new funding including from Canterbury Earthquake Kiwi Bonds	\$740 million from existing funding	Reserves (levy funded)

