STUART·CARLYON
Financial advisers for your lifetime goals

TAX AND INVESTMENTS

FINANCIAL ADVICE NZ SUPER WEDNESDAY

3 AUGUST 2022

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Agenda

I. Consider the client situation first
II. Working or retired?
III. Investment portfolio for a retired couple
IV. Family Trusts
V. Change of tax residency

I. Consider the client situation first:

One size doesn't fit all

Client discovery phase and financial plan should lead to suitable investments

Client circumstances

- Working or retired?
- An individual or a couple?
- Current income and personal tax rates
- Other investments – KiwiSaver PIE income; rental property?
- Investment portfolio to be owned by a Family Trust?
- Does the client use an accountant. If not, will the client file their tax return online?

Investment strategy is not all about tax

1. *Asset allocation* with a projected net return suitable for the *client objectives, at an appropriate risk level*

2. Your *client's experience of investing and understanding* of fund types and tax – a simple or complex solution.

One size certainly doesn’t fit all

- PIE funds have distinct advantages – simplicity for personal investors who choose tax rate at 17.5% or 28%.
- Consider the role of direct investments too – bank deposits, bonds, NZ/Australian listed shares
- FIFs (UK listed investment companies, UK, US & AUD listed ETFs and unlisted AUTs). FIFs are taxed either of two ways:
  - Fair Dividend Rate of 5% of opening value each year (FDR) (actual fund distributions are excluded), **or investor chooses:**
  - Comparative Value (CV) if lower (opening – closing value, plus distributions that year).
- Portfolio Listed Entities (PLEs) 28% tax at entity level; distributions with tax credits; **investor chooses** to exclude income, or include and utilise tax credits.

Is the flexibility to choose tax methods important?

II. Working or retired? Personal tax rates & PIE funds

Working and earning over $48,000 gross - PIEs are great capped at 28% tax

- Maximum portfolio investor rate (PIR) for multi-rate PIEs is 28% - for any amount of PIE income.
- Tax savings compared to 30%, 33% or 39%, depending on client's marginal tax rate.

When not to use PIEs for earners?

- If fund sectors not available - few index PIEs offer broad overseas shares exposure (1,400+).
- If PIE fund fees are far higher than a FIF alternative – consider outcome net of fees and tax.
- If PIE fund (or Portfolio Listed Entity) invests into an offshore ETF (less tax efficient).

What if your client has a combination of earned income and investment income?

1 April 2022 - 31 March 2023			Personal tax rates		
			Tax rate	Income	Tax
0	14,000		10.5%	14,000	1,470
14,001	48,000	34,000	17.5%	34,000	5,950
48,001	70,000	22,000	30.0%	22,000	6,600
70,001	180,000	110,000	33.0%	0	0
180,001			39.0%	0	0
Total income & Tax			Example	70,000	**14,020**
Effective rate					20.03%
Net income				**55,980**	

- Earners up to $48,000 in *either of the last 2 tax years*, can elect 17.5% PIR for a PIE fund.
- Earners under $14,000 can elect 10.5% PIR (eg: children, students, non-employed partner).
- However, there are PIE income limits for lower PIRs:
    - PIR 10.5% = taxable + PIE income to be under $48,000
    - PIR 17.5% = taxable + PIE income to be under $70,000

If personal taxable income is under $48,000…

Two part test: (1) under $48,000 taxable *and (2)* taxable income + PIE income = under $70,000

Keep client taxable income at $48,000, move $22,000 into PIEs at 17.5%.

		Tax rate	Income	Tax
0	14,000	10.5%	14,000	1,470
14,001	48,000	17.5%	34,000	5,950
48,001	70,000	30.0%	0	0
22,000	PIR	17.5%	22,000	3,850
Total income & Tax			70,000	**11,270**
Effective rate				16.10%
Net income			**58,730**	

Tax on $70,000 was $14,020 and is now $11,270

Including $22,000 as PIE income @ 17.5%, will reduce tax by $2,750

What type of client could this fit?

Retired couple with $1,950,000 to invest (save $5,500 tax)			
NZ Super	$21,250		**Investments**
Taxable Investments	$26,750	5% of	$535,000
Personal taxable	$48,000		
PIE income	$22,000	5% of	$440,000
Investment capital each (x2)			**$975,000**

Single retired person living alone with $820,000 (save $2,750 tax)			
NZ Super	$28,990		**Investments**
Taxable Investments	$19,010	5% of	$380,200
Personal taxable	$48,000		
PIE income	$22,000	5% of	$440,000
Investments for one person			**$820,200**

III. Investment portfolio case study: retired couple

Investment portfolio on platform

Portfolio of term deposits, bonds, PIEs, PLEs, AUTs, ETFs

Income sources: interest, dividends, PIE income, PLE income, FIF income.

Portfolio $2 million – retired couple receiving NZ Super	Portfolio Tax position	Per Person income & tax
NZ Super before tax		21,250
Pre-tax income (interest & FIFs*)	$55,362	27,681
Adviser & custodian cost (deductible)	-$15,362	-$7,681
Income after portfolio expenses ($20,000 each taxable added to Super)	**$40,000**	**$41,250**
Tax Payable @ 17.5%	$7,000	$6,239
Net after tax	**$33,000**	**$35,011**
Add PIE** attributed income	$34,000	$17,000
Add PLE *** distributions	$5,630	$2,815
Non-taxable projected growth	$36,766	$18,383
Projected Return	$109,396	$73,209

*FIF value $440,000 @ FDR 5% = $22,000
**PIE Value $680,000 x 5% = attributed income possibly $34,000 ($17,000 each); distributions could be lower.
*** PLE income $5,630 partly tax paid, partly imputed at 28% (excluded from PIE income limit).

What happens if an individual picks the wrong PIR?

2020 and earlier tax years

If your PIE income or loss was taxed at your correct or higher PIR, it was not included in your end-of-year tax return or assessment. However, no refund was available for overpaying PIE tax.

From the 2021 tax year onwards IRD will check if you've used the correct PIR for the full year. If not, the tax difference will be included in your income tax calculation. This will appear as a PIE debit or PIE credit in your income tax assessment. (myIR online)

PIEs are now more flexible:

- Individual tax residents will be able to offset overpaid PIE tax against their total tax liability
- if there is a net overpayment, the individual will receive a tax refund.
- IRD will allocate PIE income between joint holders if both IRD numbers and PIR provided to fund manager/platform

IRD is writing to individuals and KiwiSaver providers, PIE fund managers and wrap platforms to advise PIR changes. However, IRD may not have the full income and portfolio expenses picture. “Know your client”.

KiwiSaver funds are treated slightly differently from other Multi Rate PIEs

Income for Working for Families Tax Credits and student loans.

If your PIE income is from a locked-in fund, (eg: KiwiSaver) it is *not included as income* for Working for Families Tax Credits or student loan purposes

IV. Family Trusts

Trustees taxed at 33% - PIEs great at 28%. But are any beneficiaries on lower tax rates?

Direct investments paying interest, dividends, FIF income, PLE distributions:

- Income plus RWT, imputation credits, and foreign tax credits can flow through to beneficiaries at trustees' discretion *at year end.*
- Tax returns required for beneficiaries for any allocated Trust income.

For PIEs, Trustees must consider carefully *ahead of time* which PIR to choose:

- 0% for allocating all PIE income/tax credits/losses as taxable income to low tax rate beneficiaries
- 17.5% for allocating as *taxable* income with PIE tax credits to 17.5% tax rate beneficiaries (PIR aims to match beneficiary tax rate)
- 28% to retain as excluded income in the Trust (saving compared to 33% tax).

What if the trustees change their minds?

- If PIR of 0% or 17.5% is chosen and the PIE income is *not allocated* to any beneficiaries, it is taxable at 33% trust rate.
- If the trustees *notify* the PIR as 28%, and they subsequently *decide to allocate* to lower tax rate beneficiaries, no option to claim any overpaid tax.
- However, if the *default PIR* of 28% was applied by the PIE manager or platform, the trustees *can claim overpaid tax* if allocating to beneficiaries.

V. Change of tax residency

What if your NZ resident client moves to Australia to work for a few years?

New Zealanders are temporary tax residents in Australia (partner not Australian)

- Unique position - not taxed on income earned outside Australia (eg: from NZ, US, UK)
- But most PIE funds tax non-NZ residents at 28% (notify from date of departure).

Within the asset allocation, revisit fund selection, to avoid PIEs where feasible.

- direct fixed interest (10% NRWT or 2% AIL)
- PLEs and direct shares – possible non-resident supplementary dividends
- FIFs – UK, US listed ETFs are not taxable in NZ or Australia
- Avoid AUTs – Australian income will be taxed in Australia
- Avoid PIEs investing overseas (substitute FIFs) - unless the PIE allows 0% for non-residents
- for NZ and Australian share exposure – PIEs usually suitable.

Consider overall tax position of the client

- Aussie tax rate could be 45% if over A$180,000 earnings (PIE at 28% acceptable?)
- Client should seek local advice on tax advantages of Australian superannuation schemes.

What if your new client has not lived in NZ for over 10 years?

A new tax resident or New Zealander returning to New Zealand after 10 years:

- may be eligible for the 4-year temporary tax exemption on most types of foreign income
- known as a "transitional tax resident"
- provides a tax-free 4 years within which to transfer foreign pension funds.

Establish investment portfolio asset allocation, then select suitable structures where possible:

- AUTs and other FIFs are preferable (UK, US ETFs) to access:
    - Australian shares
    - Overseas shares
    - Global bonds
    - Overseas property and infrastructure
    - Australian fixed interest
- AUT global bond funds hedged to NZD are still FIFs (avoid PIEs investing in global fixed interest)
- Avoid PIEs investing overseas, unless the PIE allows 0% for non-residents & transitional
- PIEs or PLEs are suitable for NZ share exposure

Summary - Tax and Investments

- Consider the client situation first, other investments and knowledge of tax returns.
- Choose an appropriate asset allocation to meet client objectives
- Understand types of funds available for each sector – index, active, fees, and fund tax.
- Direct investments and FIFs may be appropriate as well as PIEs. Maintain research on a range of each type.
- Work within your area of expertise:
  - For family trust portfolios, co-ordinate with the client's accountant.
  - For non-resident or transitional tax status, check that what you can offer is in the client's best interest.

Questions for Dean and Deborah.