

Taxation Update

July 2007

Overview of the PIE changes

From 1 October 2007, the taxation of investment income for NZ resident managed funds is to be significantly improved, with the introduction of Portfolio Investment Entities (PIEs). This is a significant and positive step for investors in New Zealand managed funds.

Key features

- Investment through a PIE is to be treated in a similar way to direct investment by individuals; investors will be taxed at their elected tax rate instead of a flat rate of 33%. The fund will deduct tax at each investor's elected tax rate based on information provided by investors.
- ING will make adjustments to investors' unitholdings in a PIE to reflect the tax payable for each investor unless a zero tax rate is elected. Under the PIE rules redemptions are no longer taxable.
- Each investor needs to provide a Prescribed Investor Rate (PIR) so that tax can be calculated on their behalf. This is capped at 33% (30% from 1 April 2008).
- The PIE will pay tax to Inland Revenue (IR) and obtain any tax refund due.
- The return adjustment (where units are sold to meet the tax liability, or purchased following a refund) will be performed at the end of the tax year and when an investor fully exits from a fund.
- A partial withdrawal will be deemed a full exit where the value of the investor's remaining units is potentially close to his or her tax liability.
- Investors will be provided with a tax certificate at the end of a tax year, detailing their PIE income/loss for the tax year, foreign tax credits, New Zealand tax credits, and PIE tax (or refund).
- Zero-rated portfolio investors, other than tax exempt investors will be required to pay tax on their share of PIE allocated taxable income and return the income in their tax return in accordance with current tax rules.
- Where investors have given their correct tax rates, the tax deducted on PIE income will be a final tax and the income is not required to be included in an investors tax return.
- The tax rate for investors in a PIE is capped at 33% (30% from 1 April 2008). Individual investors whose marginal tax rate is 39% will have tax deducted from PIE income at 33% and will not be required to pay the additional 6% on their PIE income.
- Tax refunds will be provided to compensate (non zero-rated) investors for losses (excluding losses from foreign shares and New Zealand shares) and excess New Zealand tax credits made in that tax year. The PIE will advise IR at the end of the tax year the amount of tax refund, and this will be allocated to investors by adjusting units. Losses from foreign shares (subject to FDR) and New Zealand shares and certain Australian resident companies will not be deductible as gains are not taxable.
- Income earned via a PIE will not affect individual investors' entitlements to family assistance (under Working for Families), student loan repayment and child support obligations.
- Dividends received from portfolio listed companies (listed PIEs) without imputation credits can pass through PIEs without further tax being paid by investors.

Benefits to PIE investors

- PIEs investing in New Zealand shares and Australian resident-shares listed on an approved index and with a franking account will not be taxable on the gains made on the disposal of these shares. Only the dividend income from these shares will be taxable.
- PIEs will pay tax on investment income based on the tax rates of the investor.

What does this mean for investors?

New Zealand tax resident individual (natural person)

Investors will be asked to provide their Prescribed Investor Rate (PIR) and IRD number. This is the rate used to calculate the tax on each investor's allocated PIE income.

New Zealand tax resident individual investors can elect a PIR rate of 19.5% on their share of the PIE income, provided both of the following conditions can be met in either of the two immediately preceding income years:

- The taxable income (excluding PIE income) did not exceed \$38,000; and
- The combined taxable and PIE income did not exceed \$60,000.

A standard "income year" means the period commencing 1 April of a given year and ending 31 March of the following tax year.

Other New Zealand tax resident individuals will pay tax at the rate of 33%.

Note: The lowest PIR is 19.5%; an individual cannot choose 0%. If investors are currently not paying tax on income because they have carried forward tax losses from other investments, they will still be subject to tax on PIE income at 19.5%. Investors cannot file a tax return to recover tax paid on PIE income.

If an IRD number is not provided or no election is made, the default rate of 33% will apply.

Apart from ensuring that the PIR is correct, and re-confirming it annually, investors will have no other tax obligations.

Joint investors

Joint investors who are "natural persons" will have tax paid based on their elected PIR. If both investors have a PIR of 19.5%, this rate will apply to the investment. If the joint investors have different rates, the higher rate of 33% should be elected.

In these circumstances, it is not possible for the joint investor on the lower rate to recover tax by filing a tax return, as this is a final tax. Therefore, it may be preferable for joint investors with different PIR rates to split the investments and invest under their own names.

Family trusts

Family trusts can either:

- Elect a PIR of 33%, (this will reduce to 30% from 1 April 2008) where tax will be deducted at this rate and the PIE income will not be required to be included in the trust's tax return, and pay tax; or
- Elect a PIR of 0%, where the trust will be treated as a zero-rated portfolio investor and will be required to return and pay tax on the PIE allocated income. (Family trusts that wish to vest PIE income to a beneficiary on a lower tax rate or that have direct expenses should select this option.)

New Zealand tax resident entities (such as companies, unit trusts, charities and superannuation funds)

New Zealand tax resident companies and charities must elect a PIR of 0%. Trusts, unit trusts and superannuation funds (including those that are PIEs) can either choose to be taxed at 33% or be zero-rated portfolio investors. Zero-rated portfolio investors, must include PIE income in their returns. If the entity is a PIE it will flow through the income through to its investors.

Non-residents

The PIR rate for non-residents (individuals and companies) is 33% (30% from 1 April 2008). Investors will not be required to return this income in a New Zealand tax return (if they are required to file one). It is recommended that non-residents seek specialist tax advice in these circumstances.

Nominee/wrap

A qualifying nominee is required to advise the PIE provider that it is holding its interest as a portfolio investor proxy, and it must elect a 0% rate.

A portfolio investor proxy is required to perform in the same way as a PIE (that is, make tax payments and investor return adjustments in respect of the investors in their holding). OneAnswer will act as a portfolio investor proxy. If an election is not made, the default rate of 33% will apply. This will not be beneficial for 19.5% investors under the nominee, as PIE tax is a final tax.

Partnership

A partnership can elect a 19.5% rate if all partners are 19.5% investors, otherwise the 33% rate must be used.

Pre PIE tax losses

Tax assets created from realised taxable losses incurred prior to 1 October 2007 can be carried forward by the fund and offset against the future taxable portfolio investment income of the fund. These are referred to as 'formation losses'.

Whether formation losses can be utilised will depend on the total value of the tax losses for the fund, the size of the fund and the level of PIE income generated.

Where the formation losses are less than 5% of the market value of the fund's investments, no restrictions apply. If the formation losses exceed 5%, the fund may only use 1/1095 of the loss per day for the first three years.

Where formation losses for the day are not able to be utilised, these can be carried forward and offset against future income without any timing restriction.

From 1 October 2007, ING does not intend to recognise tax losses in the unit price. This change will affect a limited number of funds and the change in policy will be introduced on a case-by-case basis. Note, this is a change to the recognition of formation losses only and does not affect the usage of these losses.

Which ING funds will be PIEs?

Unit trusts (including master trusts), group investment funds, superannuation schemes and companies (other than life insurers) that are New Zealand tax residents can elect into the PIE regime, provided they meet the PIE eligibility criteria. As the PIE regime is elective, not all managed funds will elect into the regime. Our intention is that all retail funds managed and administered by ING New Zealand will elect into the PIE regime, with the exception of the ANZ Capital Protected Fund.

Related changes

In coming months, there will be a number of commercial changes made to the funds as part of our preparations for the introduction of PIE. These include the following:

- Cash and deemed distributions from redemption of units in PIEs will not be taxable from 1 October. Distributions will not have imputation credits attached, and distribution and redemptions don't need to be separately identified or disclosed on tax returns.
- Accordingly ING's New Zealand resident managed funds – with the exception of ANZ FlexiCash, ANZ FlexiMortgage Income Trust and Thoroughbred Cash Fund – will no longer distribute income after 31 August 2007. These three funds will be distributing PIEs, but the distribution will not be taxable income. Tax will be payable at year end and on exit. Investors requiring regular cash flow can set up regular redemptions. Note, distributions from the ING Diversified Yield and Regular Income Funds are unaffected by these changes as they are non-resident funds.
- As redemption gains are no longer taxable, it will be beneficial for investors to withdraw investments using the redemption option. Redemptions are classified as distributions and are therefore treated as non-taxable. As a result, from 1 October 2007, ING will no longer offer the manager buyback withdrawal method.
- ING will provide a tax statement for the period 1 April to 30 September 2007. Going forward ING will provide a statement detailing PIE income, tax paid and related information to investors each year. Due to the change in tax treatment ING will not be providing tax statements in respect of the distributions and redemptions.

In the next edition of our client magazine *Investor Focus*, we will be providing investors with details of the new PIE rules. We also intend to write to investors in July/August seeking confirmation of their IRD number and their PIR.

For more information contact your ING Business Development, or Relationship Manager.

