



**A Fair Economy.
A Strong Future.**

Q&A on tax relief – technical information

A. PAYE

How do taxpayers make sure they pay the lower tax rates?

Employers or the Ministry of Social Development will automatically start deducting less PAYE tax from employees' and superannuitants' first pay period that ends on or after 1 October 2008.

However because the PAYE system can be less accurate when composite rates (for an explanation of composite rates see the next question) are used, some taxpayers may end up having too much PAYE withheld. This is because when a new tax rate is introduced part way through the tax year, it can mean that a person whose income has fluctuated during the year may end up paying too much, or too little tax. For example, if a person earns the majority of their income in the second half of the year (when the rate is lower and thresholds change) they may end up paying too little PAYE. Alternatively, if a person earns the majority of their income in the first half of the year (when the rate is higher) they may end up paying too much tax.

If taxpayers are concerned that they may have paid too much PAYE during the year, they should request a Summary of Earnings from Inland Revenue after the end of the tax year. This statement, which will be available from May 2009, sets out all the income on which PAYE or withholding tax has been paid during the year. Taxpayers can then calculate the tax payable using the personal tax calculator on Inland Revenue's website.

If the calculator shows too much tax has been paid, then a personal tax summary can be requested from Inland Revenue. This request can be made online or by contacting Inland Revenue on 0800 257 444. If the personal tax summary shows that a refund of less than \$200 is owed, it will be automatically paid to the taxpayer. Otherwise, the person needs to confirm the personal tax summary details with Inland Revenue first. If, on the other hand, the personal tax summary shows that tax is owed, then this must be paid by 7 February 2010.

Employees who have had a special deduction rate calculated for them by Inland Revenue may need to have the rate recalculated by Inland Revenue to take into account the tax changes.

If the new tax rates are being applied from 1 October 2008, will that mean that tax will be calculated on two different rates during the year?

Yes. A *composite* tax rate will apply for a person's tax obligation for the year to 31 March 2009.

The composite tax rate schedule for the year from 1 April 2008 to 31 March 2009 is:

Income range	Composite tax rate applied
\$0 - \$9,500	13.75%
\$9,501 - \$14,000	16.75%
\$14,001 - \$38,000	21.00%
\$38,001 - \$40,000	27.00%
\$40,001 - \$60,000	33.00%
\$60,001 - \$70,000	36.00%
\$70,001 and higher	39.00%

What is a 'composite' tax rate?

Although pay-as-you-earn tax (PAYE) is withheld by employers and paid over to Inland Revenue throughout the year, the final end of year tax obligation is based on the income earned on an annual basis, i.e., the total income at the end of the tax year (31 March). In years when the tax rates do not change, or when income is received on a regular basis throughout the year, the PAYE system is very accurate at withholding the correct amount of tax.

From 1 October 2008, the PAYE rates will be adjusted to reflect the new rates announced in the Budget. When tax rates are changed part way through a year (as is happening this year), an average of the new and old rates are applied across the entire year to determine a person's annual tax liability. The average tax rates are called composite rates.

What is happening to the Low Income Rebate?

The Low Income Rebate (LIR), or lowest tax rate, is being removed and replaced by a new low statutory tax rate of 12.5%.

Under the old rates the statutory tax rate on income under \$38,000 was 19.5%; however, the LIR reduced this statutory rate by 4.5% for income under \$9,500, producing an effective rate of 15%. The value of the LIR is reduced by 1.5% for income over \$9,500 which creates the 21% rate on income up to \$38,000. At the moment, taxpayers who receive only 'passive' income (such as interest and dividends) do not get the LIR. However, these taxpayers will get the benefit of the new tax rates. Over time, income growth has meant that the LIR has provided less relief to low income taxpayers so the government has decided to replace the LIR with a new low rate of 12.5% on income up to \$20,000 (by 1 April 2011).

What if taxpayers end up paying too little PAYE during the year as a result of the composite rates?

If a taxpayer calculates that there is tax to pay (after requesting a Summary of Earnings and using the personal tax calculator on the IRD website), the taxpayer will, not be required to pay it if:

- Their only income was from income taxed at source (like PAYE);
- The taxpayer has operated on the correct tax code throughout the year; and
- The taxpayer is not required to request a Personal Tax Summary for any other reason (for example, the taxpayer may be required to request a Personal Tax Summary if they are entitled to Working for Families tax credits).

What if a taxpayer earns income from more than one job and pays secondary tax on income from the second job?

If a taxpayer has a second job, then the income from the second job will be withheld at a secondary tax rate by the employer. These secondary tax rates apply because the second employer does not know how much a taxpayer will earn from their first job and does not know the exact amount of PAYE to withhold for this second job.

While the bottom rate is being reduced to 12.5%, no new matching secondary tax code will be introduced in October this year. This is mainly due to concerns that introducing a new rate immediately would increase complexity for employers. However the government is considering whether to introduce a new lower secondary code from 1 April 2009.

Not introducing a new secondary rate does increase the chance that too much or too little PAYE is withheld. If this occurs, a taxpayer can either:

- Request a special tax code from Inland Revenue that applies a lower PAYE withholding rate to reflect the taxpayer's special circumstances, or
- Continue to use existing tax codes and request a personal tax summary at the end of the year to determine whether there is tax to pay or a tax refund due for 2009.

The information above is also relevant to superannuitants or beneficiaries who are likely to pay secondary tax on any wage and salary income.

B. SAVING

What do the personal tax cuts mean for the tax paid on other income, e.g., tax on interest?

The current resident withholding tax rates on interest income will continue to apply for the time being while we discuss the impact of the changes with the banking and financial services sector. These current rates are 19.5%, 33% and 39%.

As the bottom personal tax rate is going down and tax thresholds are changing, it is possible that too much tax may be withheld. This can be checked using Inland Revenue's online personal tax calculator and refunds can be received through requesting a personal tax summary at the end of the year ending 31 March 2009.

How will the personal tax cuts affect the Portfolio Investment Entity (PIE) tax rates that are applied to managed funds like KiwiSaver?

The PIE tax rates and thresholds will remain the same for the time being while we discuss the impact of the tax rate changes with the managed funds industry. These current rates are 19.5% and 30%. The government will decide later whether any changes to the PIE tax rates should be made. As the PIE tax is a final tax there will be no need to file a tax return to account for the rate changes.

C. PROVISIONAL TAX

How will the personal tax cuts affect provisional taxpayers?

Provisional taxpayers who estimate their provisional tax liability will need to apply the composite tax rates to determine their tax liability for the current year and determine whether they wish to recalculate their provisional tax for 2009 and the payments due over the balance of the year. In addition, for those who use the standard method to calculate their provisional tax, the safe-harbour for this year will be the standard uplift (105% of last year's tax or 110% of the tax from two years ago) based on the earlier residual tax less \$730 in order to reflect the benefit of the tax rate reductions. Inland Revenue will provide information to assist provisional taxpayers to determine their future liabilities.

D. WORKING FOR FAMILIES

If the new Working for Families rates are being applied from 1 October 2008, won't that mean that entitlements will be calculated on two different rates during the year?

Yes. Working for Families tax credits are calculated on the basis of a full tax year (1 April – 31 March). This change is being brought in mid-year, so Inland Revenue and the Ministry of Social Development will need to make an adjustment to ensure that families get the full benefit of the changes. If Working for Families tax credits are received weekly or fortnightly, the higher Family Tax Credit rates will be received from 1 October 2008. If tax credits are received in a lump sum at the end of the year, the entitlement will take into account the current and new Family Tax Credit rates and income thresholds (similar to the composite adjustment that will be made in light of the tax cuts).

Is there an increased likelihood that our Working for Families entitlement will be overpaid?

Yes. If Working for Families tax credits are received weekly or fortnightly and family circumstances change in the second half of the year (for example, if a family welcomes a new baby), the family could receive an overpayment. Since this overpayment is likely to be very small for most families, the government has decided that any overpayment caused by the changes will not be recovered (providing there has been no dishonesty).

People will need to continue to inform Inland Revenue if there is a change in family situation or family income that may affect their entitlement.

E: EMPLOYERS

What do employers need to do?

Employers will need to use the new tax rates and thresholds from 1 October 2008. If an employer manages the PAYE of employees, Inland Revenue will send them a new tax table. Inland Revenue's online calculator will also be updated. The new tables and calculator will be available in early September 2008 to give employers enough time to recalculate PAYE deductions ahead of the 1 October 2008 implementation date.

Doesn't implementation from 1 October 2008 mean that there's more work for employers?

The impact on employers should be quite modest as the changes essentially mean just using a different set of tax tables than employers currently use. The 1 October date does mean that employers will use two sets of tables in the 2008/09 year; one for use from 1 April to 30 September 2008 and a second set for use from 1 October to 31 March 2009. Inland Revenue will work with employers and payroll agents to make the transition as easy as possible.

What's happening with Employer Superannuation Contribution Withholding Tax (ESCWT)?

From 1 October 2008, the rates and thresholds for ESCWT will change. Employers will need to use the new rates and thresholds to determine how much tax to withhold on employer superannuation contributions.

Inland Revenue will provide more information about the new rates in due course.

What about extra pays?

Lump sum payments made to employees are known as 'extra pays'. Tax on extra pays is currently withheld at 21%, 33% and 39%. These will not be changing. However, employers and PAYE intermediaries will need to use the new thresholds to calculate the annualised pay of employees who receive extra pays.

Inland Revenue will provide more information about the new rates in due course.

How will the personal tax cuts affect fringe benefit tax?

The multi-rate fringe benefit tax rates will change for the adjustment to personal income tax rates and thresholds. This will include applying a composite rate for the 1 April 2008 to 31 March 2009 income year.

Employers still have the option of paying fringe benefit tax of 64% on all fringe benefits rather than applying the multi-rates.