CARTER & ASSOCIATES
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NEWSLETTER

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GOLD PARTNER

Ring-fencing Rental Losses

Labour's pre-election manifesto proposed to increase the fairness of the tax system and improve housing affordability. In the six months since the Labour-led coalition entered Parliament, we have started to see some changes filtering through. As part of the proposals aimed at house prices, Inland Revenue has recently released an Issues Paper proposing to ring-fence rental losses, with draft legislation likely to follow once Inland Revenue has considered public responses. So how would the rules work?

People derive income from multiple sources, such as salary / wages, business income, interest, dividends and rental income. It is a fundamental feature of NZ's tax system that a person is taxed on their total income from all sources, whether a profit or loss.

This aggregation allows losses incurred from rental properties to be offset against other income, reducing a taxpayer's total income and corresponding tax liability. The Government's concern is that this mechanism allows property investors to take on high levels of debt to finance their property investments, giving rise to tax losses, effectively subsidising the rental portfolio through a reduced tax liability.

The high-gearing offers an advantage compared to owner-occupiers because their interest cost is not tax deductible.

The proposed ring-fencing rules contained within the Issues Paper will eliminate this advantage by preventing rental losses from being offset against other income. Instead, rental losses will be 'ring-fenced' and offset against future rental income, or any tax incurred on the future sale of the property.

Labour originally indicated losses might be ring-fenced by individual property. Thankfully, the proposed 'portfolio approach' is more logical, enabling investors to pool their profits and losses from all residential properties, including overseas properties. If enacted, the rules will apply to all rental properties irrespective of how they are held, i.e. the rules will apply to individuals, companies and trusts. The proposed rules also use the existing definition of 'residential land'. Thus, the rules will not apply to commercial property or property subject to the mixed-use asset rules.

There is complexity in the new rules because they can impact people that don't hold rental properties.

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For example, if a person has borrowed to purchase shares in a company and that company uses the funds to purchase a rental property, the interest incurred by the shareholder is normally tax deductible.

In this situation, if 50% or more of the company's asset value is derived from residential properties the company will be classified as "residential property land-rich". Amounts paid to the shareholder (e.g. dividends) will be classified as "rental property income" and their interest expense will be classified as "rental property loan interest".

The rental interest can only be deducted against "rental property income" derived from the company, or the individual's other rental properties, with any excess loss ring-fenced to the person.

The application of the proposed 50% asset test is currently unclear – the issues paper does not indicate whether it will be based on market value or historical cost. This will undoubtedly be addressed during the consultation period. If enacted, the proposed rules may be phased in from the start of the 2019 – 2020 income year. This will allow investors time to adjust to the new rules and provide the opportunity for taxpayers to rearrange their affairs before the rules are adopted in full.

Online shopping about to cost consumers more

GST will apply to most low-value imported goods from 1 October 2019

Currently, goods purchased from overseas are generally not subject to GST unless the total GST and duty payable on those goods is at least $60. Where no duty is payable, this roughly translates to GST applying to goods costing a total of $400 or more.

The days of being able to buy these low-value goods from overseas websites free of GST may, however, be coming to an end.

The Government has released a discussion document "GST on low-value imported goods: An offshore supplier registration system" which proposes requiring offshore suppliers to register and account for New Zealand GST on low-value goods which are sold to New Zealand consumers when the offshore supplier makes total supplies to New Zealand consumers in excess of NZ$60,000 in a 12-month period.

Referred to as the 'Amazon Tax', it is very similar to the 'Netflix Tax' which came into effect in October 2016 and compels suppliers of remote services to charge New Zealand GST if they make supplies to New Zealand consumers in excess of the $60,000 GST registration threshold.

Online marketplaces and re-deliverers of offshore goods into New Zealand may also be required to register and account for GST on low-value goods if the NZ$60,000 registration threshold is exceeded.

GST on goods which cost more than NZ$400 will continue to be collected at the border by New Zealand Customs.

If the proposals proceed, it is likely that offshore sellers of low-value goods will pass on the additional GST cost to consumers. This will make buying goods from offshore retailers more expensive, in line with the intention to level the playing field for local retailers who have long campaigned for equal tax treatment with offshore retailers.

The extension of GST to low-value items is conservatively estimated to raise an additional NZ$87m in GST for the Government (this is likely to be much more given that the Netflix Tax was proposed to bring in an additional $40m annually and has in fact brought in $162m since coming into effect on 1 October 2016).

The extension will also bring New Zealand in line with other countries: Australia and Switzerland are introducing similar rules from 1 July 2018 and 1 January 2019 respectively and the EU has announced plans to implement a similar system for the collection of VAT by 2021.

Submissions on the discussion document close on 29 June 2018, with draft legislation expected to be introduced by November 2018. If enacted, the new rules will apply from 1 October 2019.

Cryptocurrency and tax

Over the last decade, the use of digital or virtual currencies, known as “cryptocurrencies”, has grown dramatically in popularity. A single piece of Bitcoin is currently valued at over $9,000 NZD. Some New Zealand retailers have already begun accepting Bitcoin as a form of payment, which has led to the Inland Revenue releasing a ‘Questions & answers’ considering the tax treatment of cryptocurrency.

For tax purposes, cryptocurrency is treated as property, which means that foreign currency gain or loss provisions do not apply. However, if a New Zealand business accepts cryptocurrency as a form of payment, the amount is treated as taxable business income based on the value of the cryptocurrency at the time it is received.

Any gain on sale of cryptocurrency is assessed by considering the original purpose for acquiring the currency. If the currency was acquired with the purpose of disposal, any proceeds made from selling the currency are taxable. IRD consider the nature of cryptocurrency means it is unlikely that a person would acquire it without the intention to sell or exchange it, meaning the majority of gains made on disposals would give rise to a tax liability.

If you invest or trade in cryptocurrencies, be sure to keep an eye out for further developments from Inland Revenue, as they intend to refine its tax treatment as more information becomes available.

If you have any questions regarding this Newsletter, please don’t hesitate to contact the office - 09 5799157