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NEWSLETTER

May 2019

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Tax Working Group

The Tax Working Group (TWG) released its long awaited Final Report ('the Report') on 21 February 2019, following a 13 month review during which the Group received over 7,000 public submissions. The report contained 99 recommendations for the Government's consideration; including the introduction of a broad Capital Gains Tax ('CGT').

Two months later the coalition Government ruled out the introduction of a CGT for the foreseeable future. The current Government is a coalition and without consensus it could not move forward.

Where does this leave us? What about the remaining 97 recommendations? The government has provided a written response to each of the TWG's recommendations. However, the overall theme is that there will be no significant change or major evolution.

A number of the recommendations by the TWG were to make no change. For example, the TWG recommended the corporate tax rate should remain at 28% and no progressive corporate tax rate system should be introduced. The government has endorsed maintaining the current business and personal income tax regimes as they are.

The government has agreed to investigate taxing land banking, as this may trigger land development. This 'power' could be passed to local government. This has been referred to Inland Revenue to be added to its (IRD) tax policy work programme (TPWP) for consideration.

The Government is to continue its focus on the taxation of multi-national corporations (MNCs). The government is working closely with the OECD to achieve equity regarding income tax received by all jurisdictions in which MNCs operate. A draft discussion document is due to Cabinet by May 2019 regarding the taxation of the digital services economy, informally labelled the 'Google Tax' or 'Facebook Tax'.

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Part of the TWG's final report covered what the revenue from a CGT should be used for, and therefore proposed a number of 'spending packages'. The packages included bringing back depreciation on buildings, reducing taxes on income from savings, and increasing the income threshold for the 10.5% personal tax rate from $14,000 a year to at least $20,000 a year.

However, without the additional revenue that would come from a CGT, the Government has ruled out such changes as no longer attainable.

Most of the TWG's recommendations have been referred to IRD for 'potential' inclusion on the TPWP. What action the TPWP drives remains to be seen. Some of these recommendations will be addressed as a by-product of the IRD's ongoing transformation project. Through its improved systems there will be an enhanced focus on data and closer interaction with businesses and individuals using the online platforms, therefore work on enhancing the integrity of the tax system has already been under way for some time.

Ultimately, the outcome of the TWG process is mirrored by NZ's MMP system. Action (as opposed to inaction) by a coalition government requires consensus from the members of that government. That consensus did not exist.

Ring-fencing rental losses

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.

Effective from the commencement of a taxpayer's 2019-20 income year, rules to ring-fence losses incurred with respect to residential investment properties, from being able to be offset against the taxpayers other income. Some of the main feature of the new rules are proposed to be:

- The rules will apply to residential land as that term is defined for the purpose of the bright-line test. Excluded however will be the taxpayers main home, property subject to the mixed use asset rules, certain employee accommodation and property that will be taxed upon sale;
- The rules will apply on a portfolio basis, although taxpayers can elect a property-by-property basis;
- Ring-fenced deductions will carry forward to the next income year, for offset against future residential rental income or income on the sale of residential land;
- Anti-avoidance rules will exist to prevent abuse of the new rules via the use of interposed entities e.g. where someone has borrowed to acquire an interest in the interposed entity as opposed to that entity directly borrowing the necessary funds to acquire the residential investment property; and,
- Note that the definition of residential land is not limited to land in NZ.

Tax pooling

Inland Revenue (IRD) charges a high rate of interest on late tax payments (currently 8.22%), and in some circumstances the complexity of the provisional tax regime makes interest charges hard to avoid. Add on late payment penalties, and the cost of meeting your tax obligations starts to feel punitive.

The use of tax pooling services is not yet commonplace for all taxpayers, perhaps due to a lack of understanding regarding how the system works. To illustrate, imagine you have had an amazing year and your income has significantly increased compared to prior years. The problem you now have is that you have underpaid your provisional tax. You receive a statement from IRD and it shows your liability has gone up due to interest charged from your third provisional tax date of 7 May 2018.

Meanwhile, your neighbour has had a poor year and her income has dropped. She has received a statement from IRD showing that she is due a refund because she overpaid her 7 May 2018 provisional tax payment. In this situation, a tax pooling intermediary, such as Tax Pooling Solutions (TPS), Tax Management New Zealand (TMNZ), and several others, can connect people that have overpaid their tax with people that have underpaid their tax. Taxpayers deposit tax payments with a tax pooling intermediary to be held as part of the 'pool'. Funds held in the pool can be used to meet a person's own liability or 'sold' to another taxpayer.

Tax pooling basically allows you to purchase your neighbour's "tax" and transfer it into your account with IRD, with an effective date of 7 May 2018. From IRD's perspective, there is no shortfall at 7 May 2018 and therefore no use of money interest (UOMI) is charged.

As another example, if IRD reassess a past tax return resulting in an increased tax obligation for a prior year, historic funds held in the pool year can be 'purchased' and used to offset the increased obligation. This is advantageous to the taxpayer, as the intermediary charges less to purchase the historic tax credits than what IRD charges if paid directly. Conversely, for those taxpayers that have paid excess tax into the pool, the intermediary provides a higher interest return than IRD. Hence, tax pooling provides an advantage to taxpayers that have both underpaid and overpaid their tax.

Tax pooling provides taxpayers with a degree of flexibility regarding how they go about meeting their tax obligations. The days of being hit with excessive IRD interest and penalties if you get your provisional tax wrong are effectively over. Instead, there is a fallback mechanism available at commercially acceptable rates in the event that things go wrong.

Short-stay accommodation

Inland Revenue (IRD) is currently consulting on tax obligations that arise on various forms of residential rental, such as renting out a room within your home, or letting property using a peer-to-peer platform, such as Airbnb or Bookabach.

One of the proposed changes relates to the 'standard cost' rules for boarders or home-stay students. Currently, income earned below the threshold of $266 a week for the first two boarders and $218 per week for each subsequent boarder, is tax free and doesn't need to be included in a tax return. IRD propose to reduce this weekly threshold to $183 per boarder (subject to annual CPI adjustments). Or, taxpayers can elect to return all income and expenses relating to boarders in their tax return, which may be favourable if they incur considerable costs.

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A similar rule is also proposed for taxpayers providing short-stay accommodation in their own home (e.g. Airbnb), by setting standard nightly costs for deductions, with income above the standard cost needing to be declared. The suggested thresholds are $50 a night for homeowners, and $45 where the host is renting their home. However, there will be various criteria to use this concession, for example a rental limit of 100 nights per year.

Renting out a property that is also used privately is currently a complex tax area, so changes to simplify the regime are welcome.

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