A READER ASKS:

"There has been a huge amount of publicity and commentary about the Tax Working Group and the recommendations about tax changes and a possible Capital Gains Tax. What does Baker Tilly Staples Rodway think about this?"

ASK AN EXPERT

Capital gains tax Myth or reality?

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Later this month the government will be announcing to what extent they would be adopting the recommendations of the Tax Working Group. There has been significant media discussion about the proposals of the Tax Working Group since the report was released on 21 February.

To Recap

As a quick recap, we outline the key proposals in the report:

- A broad-based capital gains tax, excluding the family home and personal assets
- Some tax relief for lower income earners
- Limited KiwiSaver sweeteners
- Potential restoration of depreciation deductions on buildings

Who would be Affected?

If implemented as per the recommendations, everyone who has an asset that isn't their personal home or a personal asset (boat, car, art, etc.) would be affected. The groups impacted by the recommendations of the Tax Working Group include:

Business Owners

Business owners would be impacted when it comes time to sell their business. Apart from the obvious tax obligation, being tax on the proceeds less business value at 1 April 2021, key issues include:

- Valuation of the business on 1 April 2021 – several options are proposed
- Maintenance of excellent records over the entire lifetime of a business (for valuation)
- Limited rollover relief (small businesses, defined as turnover of less than $5 million per annum have some relief proposed)
- Complexity where the family home is used for business purposes

Farmers

The impact on farmers would be similar to business owners above, with the added

impact of the farm land being subject to capital gains tax. Apart from this, other impacts may include:

- Limited rollover relief making farm size trading up difficult (farmers often grow their business by 'trading up' to larger farms)
- Farms are long-term multi-generational businesses and planning has been based on the tax rules that have been in place for years.
- Potential tax when passed to the next generation, although would be likely to be concessions.

Landlords (Residential and Commercial)

Residential landlords have accepted lower yields in the expectations of a tax-free capital gain on exist. Renters may feel the squeeze as landlords run the ruler over their overall profit.

For landlords, this may be the last straw having already faced proposals to toughen up the Residential Tenancies Act and the planned introduction of residential rental loss ring fencing from the 2020 year.

Counteracting the cost may be the potential reintroduction of depreciation on buildings.

Succession Planners and Procrastinators

In some respects, this would be the group potentially worst impacted by the recommendations of the Tax Working Group. This is because capital gains tax events may inadvertently be triggered when engaging in restructuring. Tax rules around restructurings are already complex including debt forgiveness rules and shareholder continuity rules for losses and imputation credits. In the absence of robust rollover relief for estates, trusts would become even more attractive.

Lower rates of tax on the first $500,000 are proposed where a business is being sold because the owner is retiring.

Bach Owners

The only residential property to be exempt from a capital gains tax would be the family home, whether owned personally or in a trust. This excludes the family bach, with the result any capital gain arising after 1 April 2021 on the family bach would be subject to tax.

Low Income Earners

The key sweeteners focus on low income earners, and are:

- Extension of the lowest tax bracket
- Reduction of PIE rates for KiwiSaver funds by 5% on the lowest two brackets (to 5.5% and 12.5%)
- Increasing the KiwiSaver member tax credit to 75 cents for every dollar saved up to the current contribution cap
- Refund of employer superannuation contribution tax for KiwiSavers earning less than $48,000 per annum

Crystal Ball Gazing

With three parties in government, all of whom have differing objectives, it is unlikely all the recommendations of the Tax Working Group would pass into law. What is more likely is more that palatable (from a political point of view) pieces of the proposals will be implemented with more difficult pieces being shelved until a future date.

While three out of eleven members of the Tax Working Group disagreed with the breadth of a proposed capital gains tax, all members of the Tax Working Group agreed with a broad capital gains tax on land. The minority group is of the view a capital gains tax on land should represent a further step in the incremental expansion of the tax system which could then be expanded gradually if it was felt appropriate, and the tax collectable was worth it.

If you are interested in reading the report, it is available at www.taxworkinggroup.govt.nz/resources/future-tax-final-report

A broad capital gains tax on land appears to be accepted by many quarters and we would be surprised if this piece did not progress. The concerns of business and the agricultural community appear to have been around the limited scope of rollover relief and the potential negative impact on the farming sector. We anticipate broader rollover relief and farm specific relief, with Winston Peters likely leading the charge in this area.

The government has effectively promised a fiscally neutral package where they take with one hand and give with the other and we anticipate that would be the position adopted. It is interesting to note that 43% of capital gains tax revenue under a broad-based regime is expected to be derived from residential land transactions after 10 years, so even a residential land-only capital gains tax would provide the government scope to provide other concessions.

Looking further, it seems likely environmental taxes will be reviewed at some point in the future. The New Zealand government faces pressure both at home and abroad to do something about greenhouse emissions and given New Zealand's unique emissions profile, it is going to be difficult to meet our international obligations without some form of environmental taxation.

The government would also be looking very carefully with one eye to the 2020 election. Overseas experience shows election campaigns fought on tax issues are often not favourable to parties advocating for new or increased taxes.

Conclusion

The big question is what happens with the coalition partners, New Zealand First, in particular. The next eighteen months may see much debate on the shape of a capital gains tax with the 2020 election likely being fought over it if the government decides to proceed, even in limited form. Political calculations will play a big part but if even half the proposals proceed, this would represent the biggest change in the tax landscape since the introduction of GST in 1986.

We should emphasise none of these proposals are even in bill form at the moment and so there is no need to panic! However, now is a good opportunity to consider your affairs more generally, including structuring and succession planning.

If you have any concerns about how the proposals may impact on your affairs, would like to consider structuring or succession planning issues in general or would like to submit on any legislation proposed by Parliament in this regard, contact your Baker Tilly Staples Rodway advisor.

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Take advantage of our expertise and send your question about finance, accounting, audit, tax, and other business-related areas to askanexpert@bakertillysr.nz and one of our specialists may answer it in a forthcoming issue of *Numbers*.