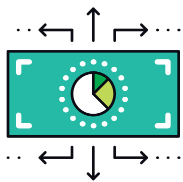
TAX TALK

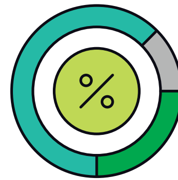
COVID-19 Further Measures and Property Tax Announcements

The last few weeks has seen a further flurry of activity with the extension of the small business cashflow scheme, the FBT interest rate lowered, the definition of finance lease temporarily changed and the release of guidance on property. We provide our update on these topics below.



Small Business Cashflow Scheme Extended

The government has announced applications for the small business cashflow scheme have been extended to the end of this year.
The other conditions of the scheme have not changed (refer article here).
This is a welcome development as it gives businesses more time to decide whether it is appropriate to make use of the scheme. If you have any queries in relation to the small business cashflow scheme, please contact your Baker Tilly Staples Rodway advisor.



FBT Interest Rate Lowered

The rate of interest applying for fringe benefit tax purposes to employment-related loans has decreased from 5.26% to 4.50% effective from the quarter commencing 1 July 2020. This rate is also an acceptable rate of interest for a company to charge its shareholders on loans to prevent a deemed dividend arising.

If you have any queries about employment-related loans or loans from a company to its shareholders, please contact your Baker Tilly Staples Rodway advisor.

Finance Lease Definition Temporarily Changed

Inland Revenue have released a determination temporarily modifying the definition of a "finance lease" for tax purposes. Ordinarily, a lease with a lease term of 75% or more of the estimated useful life of the asset is treated as a finance lease for tax purposes with significant consequences. However, where a lease that is normally treated as an operating lease for tax purposes is extended during the period 14 February 2020 to 30 November 2020, the 75% threshold is now 75% of the estimated useful life of the asset plus an additional 18 months.

Inland Revenue have imposed specific conditions around which taxpayers can apply this variation. If you have any queries about leases for tax purposes and whether you can utilise this temporary change in definition, please contact your Baker Tilly Staples Rodway advisor.

Inland Revenue Guidance on Property

As many long-time readers of Tax Talk would be aware, Inland Revenue has taken particular interest in property over the last few years, seeing this as an area where errors are likely to result in large tax consequences. Inland Revenue, in an attempt to better educate taxpayers, has released guidance on four key property related topics:

- GST treatment of short-stay accommodation
- GST supplies of residences and other real property
- Tax issues arising from owning foreign residential rental property
- The tax treatment of loans used to finance foreign rental property

GST treatment of short-stay holiday accommodation

The rise of the sharing economy, and in particular Airbnb and Bookabach, has seen a flood of properties being made available for holidaymakers to rent. While residential rental properties are not subject to GST, properties rented out on a short-term basis may be subject to GST. If that is so the owners may have a liability to register for GST.

New Inland Revenue guidance discusses the requirements for GST registration, the main consequences of GST registration and what happens when the property is sold or the short-stay accommodation activity ceases. As with any other taxable activity, the provision of short-stay accommodation only results in a compulsory GST registration requirement where turnover exceeds NZ$60,000 in any 12-month period, generally speaking.

Some areas overed in the guidance include:

- Determining whether the supply of short-stay accommodation is exempt
- Calculating the NZ$60,000 threshold, especially where other activities are undertaken (e.g. tradesperson who also lets out a room) and where there are supplies to associated persons (e.g. family members)
- Calculation rules, including apportionment requirements where a property is used for both taxable and exempt supplies (this might be the case where a room is let out)
- The special rules for mixed-use assets such as holiday homes and baches
- The GST consequences arising on disposal of the property or when GST registration is cancelled

The Inland Revenue's attempt to clarify the rules should be commended. However, a house built on sand cannot stand. The apportionment rules in the GST Act have been problematic since GST started to apply in 1985. They were significantly amended around 2000 and again in 2011. We understand that they are again considering a review of these rules. The issue are not new, but hopefully, new solutions can be found.

If you own a property that you let through Airbnb, Bookabach or similar and have concerns about GST, please contact your Baker Tilly Staples Rodway advisor.

GST supplies of residences and other rental property

GST does not work well when it comes to the supply of land. Our GST system is supposed to be a transaction-by-transaction value added consumption tax. In other words, it is supposed to tax consumption as it happens.

GST works well where things like twinkies or donuts are sold. Everyone knows they are consumed. Not so with land. Land, if you will, can be consumed twice. Once by renting it while it is owned, and a second time when the owner sells the land. This runs a line through the transaction-by-transaction ideal of our GST system. In addition, land goes up in value without any value being added. This runs a line through the value added component of the tax. What you therefore end up with is pure consumption tax, which looks very similar to a tax on increases in value. This is effectively a capital gains tax by another name.

In addition, although our GST system has very few boundaries, a significant boundary issue often arises with the sale of land. Farms are a good example. The house and the farm are sold together. Conventional wisdom, based on past IRD pronouncements, have mostly treated the supply of the farmhouse as a supply that GST does not apply to and the remainder of the land as subject to GST.

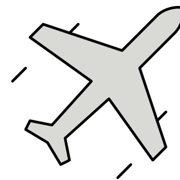
One significant issue that arises from this IRD ruling (IS 20/05) is that now the IRD says that if the farmer has claimed, what is in essence, a home office expense for income tax purposes, then that means that the farmhouse has entered the GST net, and when it is sold, GST should be charged on the supply. The farmhouse effectively becomes subject to a de facto capital gains tax of 15%.

This goes against previous IRD rulings on the matter and cuts across the underlying GST policy which is that your main home should not be subject to GST.

Further, if the reasoning in the ruling is followed an argument could be made that not just farmhouses have entered the GST net, but also all other houses where there is a home office component. This could include a significant number of private dwellings. The ruling is unfortunately silent on this point, but it may be a logical extension of its reasoning in many situations.

The potential result - a capital gains tax of 15% not only on farmhouses, but on any other house used as a home office.

The reasoning of this ruling may be correct on the black letter law, but it does not represent common practice, and neither does it follow the policy settings of the GST Act. We have raised the issue with officials and hope some retrospective remedial legislation could be put in place to solve the problem, or the ruling is withdrawn.



Tax issues arising from owning foreign residential rental property

Over recent years Kiwis have become more mobile, and therefore are more likely to own residential rentals offshore (not taking into account the effects of Covid, that is). In addition, with the influx of immigrants, many may leave a rental portfolio behind.

In an attempt to better educate taxpayers and resolve the misconceptions held by many, Inland Revenue has recently released an interpretation statement on the tax issues arising from owning foreign residential rental property. One of the most common mistakes taxpayers make is thinking that because a residential rental property is overseas that it is not subject to New Zealand taxation – Inland Revenue opens by reminding readers that New Zealand tax residents pay tax on their worldwide income and not just New Zealand sourced income.

The Inland Revenue guidance discusses the following points:

- Other countries tax rules differ from NZ’s rules
- The transitional residency rules and how this can apply
- Balance dates and available concessions
- Foreign exchange rates and conversion
- Foreign tax credits and their availability

Inland Revenue also points out that interest paid to an overseas lender is subject to non-resident withholding tax in most situations. Loan agreements between borrowers and overseas banks often include an NRWT 'gross-up clause' meaning the borrower needs to remit the NRWT to Inland Revenue in addition to paying the full amount of the interest on the loan to the borrower. There are options available to manage and potentially reduce this obligation.

This guidance is very helpful. It raises awareness among taxpayers, while also acknowledging that every situation is different. Professional advice is required when dealing with the tax impact of owning a foreign residential rental property. If you interested in the New Zealand taxation implications of owning a foreign residential rental property, Baker Tilly Staples Rodway has a team of taxation experts who will be able to provide you with advice tailored to your situation.

Application of the financial arrangements rules to foreign currency loans used to finance foreign residential rental property

The financial arrangements rules are not only among the most complex parts of New Zealand income tax legislation but are also the most easily overlooked rules by the average taxpayer. In addition, these rules can result in unpleasant tax surprises for taxpayers with foreign denominated loans.

Given many taxpayers have foreign denominated loans in conjunction with foreign residential rental properties, Inland Revenue has taken the opportunity to release guidance on the application of the financial arrangements rules to foreign currency loans used to finance foreign residential rental property.

Inland Revenue's guidance generally acts as a basic 'how-to' guide of the financial arrangement rules with specific application to foreign currency loans used to finance foreign residential rental properties. Points discussed include:

- Transitional residency
- Cash basis persons and whether a taxpayer is potentially one
- Wash up calculations needed at the expiry of a financial arrangement (called base price adjustments)
- Income and expenditure under the financial arrangement rules

Given how complex the financial arrangement rules are, we are surprised the guidance only comes in at 19 pages. However, like the guidance on foreign residential rental properties, Inland Revenue's objective is to raise awareness of the difficult issues.

Your Baker Tilly Staples Rodway advisor can talk you through the New Zealand tax consequences of foreign currency loans (and foreign currency bank accounts, which are subject to the same rules).

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