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STAPLES RODWAY

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The Tax Working Group is due to report back to the government by the end of February, but this may be earlier.

Capital Gains Tax - What is really happening?

Since the release of the interim report by the Tax Working Group, there has been a lot of panic and speculation in the press and elsewhere about the possible operation of a capital gains tax and its effect on asset values and some sectors of the economy.

In this article, we provide an update on what is expected to happen and what the key influences are.

What we Know

The Tax Working Group is due to report back to the government by the end of February, but this may be earlier.

Legislation will need to be introduced to Parliament and will go through the usual Parliamentary process (first reading, select committee, second reading, committee of the whole, third reading). The public and businesses should have the opportunity to have their say at select committee stage.

Any new tax would not come into force until 1 April 2021.

What is Likely to be Proposed

If it proceeds, the government will enact new legislation in time for the 2020 election campaign, even though it would take effect in 2021. This would remove speculation about the details of a capital gains tax during the campaign, but not speculation about its impact. Any legislation would have around 18 months to go from draft to final enactment. For legislation of this kind, this does not give much time for the drafters to get it right.

The Tax Working Group appears to be leaning toward a capital gains tax on a realisation basis. The accrual basis mentioned in the draft report seems to have been dropped (if indeed, it was ever seriously considered).

Indexation, which removes increases due to inflation from being taxed, appears to also be off the agenda. Australia tried indexation when they introduced their capital gains tax in the 1980s but abandoned the approach fifteen years later due to the complexity involved, and brought in reduced rates for individuals and trusts instead.

One of the big issues is whether a new tax will be based on value increases after its introduction, and how the valuation of the assets in the regime would be managed. This does not mean in practice that there needs to be a one-day valuation exercise for all assets and businesses, but the type of valuation required and when it would be needed are crucial points which are as yet unanswered.

Some sort of "rollover relief" appears to be likely. Roll over relief acts to defer capital gains tax from certain asset disposals (e.g. assets transferred under a will). The Tax Working Group is prohibited by their terms of reference from considering inheritance tax, and if some rollover relief is not included in the proposal, any capital gains tax would effectively behave like inheritance tax.

Other rollover relief provisions to encourage businesses to reinvest capital gains in new businesses assets are a standard part of overseas regimes, but it seems as if this may not be part of the proposed regime, which is problematic.

We also remind you that the family home is out of bounds, but baches are likely to be caught.

"Winston's Veto"

Any capital gains tax will need the support of New Zealand First to make it through Parliament. The position of New Zealand First appears to currently be to wait for the tax working group final report, to consider the proposals, and then formulate their policy. Given this, it is premature to speculate what the shape of any capital gains tax will be until New Zealand First makes its policy clear.

The machinations of MMP may also result in a capital gains tax being more permanent than what some commentators have speculated. Unless National, ACT and any other parties opposed to a capital gains tax were able to gain 61 seats in Parliament at the next election, it is unlikely that a National-led government would be able to repeal the capital gains tax, even if they were to return to office.

Baker Tilly Staples Rodway comment

Until the final report is released, any comment is partly-informed speculation, and appear to be designed to put the government off taking the final plunge. This can be good for lobbying purposes but we do not think it is fair to scare the public based on a series of extreme positions. It will be good to have a proper informed debate once the final report is released, and we will provide further comment at that time. It is a cliché, but the devil will be in the detail.

The Auckland office is also planning to organise an event involving one of the members of the Tax Working Group once the final report has been released and details of this event will be forwarded to clients closer to the time.

Loss offsetting on residential rentals to go

With the changing business landscape, it is more important now to obtain good advice before moving forward, whether you plan to retain or sell your residential rental property. Contact your Baker Tilly Staples Rodway advisor if you have any queries about either the planned legislation or the consequences of any property disposal.

In the May edition of Tax Talk (refer here), we discussed government proposals to "ring-fence" residential rental tax losses, meaning such losses could only be offset against residential rental income. Following feedback, the government has introduced legislation to implement this change.

Assuming the legislation passes through Parliament, it would take full effect from the 2019-20 tax year onward (years beginning 1 April 2019 for standard balance date taxpayers).

What has Remained Unchanged?

- The rules are proposed to apply to "residential land", using the same definition of "residential land" already existing for the five year bright-line test.
- The rules are planned to be applied on a portfolio basis, allowing investors to offset losses from one residential property against income from other properties.
- Ring-fenced residential rental or other losses from one year would be able to be offset against:
- Residential rental income from future years (from any property in the portfolio); and
- Taxable income on the sale of any residential land.
- A suite of anti-avoidance rules will be implemented, especially to prevent interposed entities from being used.

What has Changed?

- The proposed rules would not apply to accommodation provided to employees or other workers where it is necessary to provide accommodation due to the nature or remoteness of the business.
- It is proposed the rules will not apply to property owned by widely-held companies as large companies often hold residential land incidentally to their business.
- Taxpayers may elect to apply the rules on a property-by-property basis if they so wish. A property-by-property approach would be stricter than a portfolio approach. It would mean each property would need to be looked at separately, with losses on one not able to be offset against income from another. We doubt this approach would be utilised in practice.

Baker Tilly Staples Rodway Comment

Like the planned tightening of the rules on residential tenancies and the potential capital gains tax, this proposal has been previously signalled by the government and so has come as no surprise to most. It is unfortunate landlords are being blamed for problems facing the housing sector and so appear to have become targets for government action.