Tax Tonic Oct 2020

Carl Brandt & Julie Segedin

GST on sale of farmhouse

Q: For the farmhouses claim re purchase, does it matter if purchased prior to 1986 when GST started?

> *A: Yes it does make a difference as there is no input claim for assets purchased before 1 October 1985. The output would be still be the same*

Q: Are there some typos on slide 21 as we are struggling to follow the math in the $ showing

> *A:Good spotting. Please see points on slide below with explanation in red and change in **bold***

Removal of the nonsense "Cap"

- *At the beginning of the year IRD proposed that GST adjustment rules should be amended to remove "the cap"*
- *Assured cap removal will go through (BUT retrospective?)*
- *Effect GST only paid on the business % of the net increase*
- *End result for example would be:*
- *Net of GST increase in farmhouse = 200,000 ($300,000 – $200,000)*
- *Business = 20% so $200,000 = $40,000 (net business increase in value)*
- *$40,000 x 15% GST = $6,000 net GST cost on Farmhouse Correct to here*
- *Actual Return ($45,000 output – $36,000 input **– $3,000 input [20% of 15,000 assuming this wasn't claimed at purchase ie this is on top of the change of use for the increase) = $6,000 GST on 20% of $200,000 (net increase)***
- *$45,000 – $39,000 = $6,000*

[No wonder I don't do my own tax return now….all words and not enough number work ☺]

Q: What about farmhouses purchased prior to 2011 i.e. principle purpose private so no GST claimed.

> *A: The old change of use rules apply to assets where GST was claimed before 1.4.11 so if you had actually claimed 100% of the GST on the farmhouse on the basis that principal purpose was taxable but that seems unlikely. If it were the case you would have to return GST on the sale of the whole house. If you never made a claim but are deemed to now (according to IRD) by using 20% for business the new change of use rules apply.*

Q: Home office expenses 20% for farm, Type 1, calculation under the sqm rates method no GST claimed, does that mean no GST payable (20%) on sale?

A: Not according to IRD! They are saying by claiming the 20% for income tax you have dragged that portion of the house into the GST net…..

Q: Would a main farmhouse that a rental is charged to shareholders be in the net. No GST claimed on dwelling repairs and only 20% claim on power. Full rates claim as cannot dissect.

*A: Where the company owns the house but is charging the shareholder rent for **100%** of the house and not claiming GST on the repairs there is an argument that the power claim is GST a reimbursement of the employees business cost. The company is allowed to claim the GST under sec 60 as for the power the employee is acting as an agent for 20%. If the company was only charging 80% of the rent on the basis that 20% was used for the business then the farmhouse would be subject to GST.*

Q: If a client has a bare block of land and built a house on it. If they were a Type 1 farm could they have claimed 20% on the build for GST. We haven't claimed any GST.

A: According to the rules as they currently stand the answer is yes and even if they havent claimed it they will be deemed to have and on sale 20% will be subject to GST. My suggestion is to wait and see where this goes before claiming that 20%.

Q: That's batty - would mean anyone with a home office would get caught?

A: Yes it's definitely batty but it would only apply if the homeowner is self-employed and registered for GST otherwise they wouldn't be over the GST threshold and any reimbursement from a company would be just a reimbursement of expenses.

CB 12 subdivisions and minor work

Q: With regards to subdivision, are the 5% value and $50,000 absolute safe harbour both required to be met. Is it enough to meet one and have the development in the safe harbour area?

A: According to the IRD view <u>both</u> safe-harbours' need to be met, ie. the relevant subdivision needs to be under BOTH 5% of land value and under $50k.

As discussed in our webinar we think this view is unreasonably restrictive and not actually supported by case law. It is always preferable that the relevant costs are under 5% of land value – however it shouldn't be a problem if they are over $50k. In this current day and age with RMA obligations and Council standards, even the most straightforward and minor subdivision is likely to have more than $50k. Especially if it is around the cities in NZ, eg. Auckland, Hamilton, Wellington, Tauranga, Christchurch etc.

Q: So if the land has been held for more than 10years when a subdivision is commenced one cannot rely on the 'of a minor nature' rules?

A: Correct. If the subdivision scheme commences after 10 years, section CB 12 does not apply at all. Instead we need to apply s CB 13 and the criteria is a "major development" with significant expenditure on earthworks, roads, kerbing, levelling and contouring etc.

Q: Do 5% on minor subdivision penalise cheaper land areas compared to dearer places like Auckland.

A: Very good point – both the arbitrary 5% and $50k "safe-harbour's" create inconsistencies depending on where the land is. A very simple subdivision close to Auckland will more than likely break $50k. The same subdivision in a remote area (say up Northland somewhere) may well be under $50k, but could more easily break 5% of land value.

This emphasises our point in the webinar – it requires an "overall assessment" (as per the Court of Appeal's statements).

Bright-line rules – parents helping kids

Q: Hi Julie, similar to the parents helping kids - can you please confirm - there is a Trust that owns two houses. On separation the husband and wife are to take one house each. Both are settlors in the trust and they are living in the separate houses. Is there a bright line issue transferring out the house from the trust to the individuals?

A: This would no doubt be done under a Relationship Property settlement so both houses would be treated as being owned by each individual on the date the Trust first acquired them. For the house they lived in most of the time the main home test would apply to the total length of time it was owned including the trust time. So exemption will apply to that even if it was sold within the bright-line period For the other one the Main home wont apply for the period the trust owned it so if it was sold within the bright-line period (settlement date for Trust acquisition) and eventual disposal to third party (signing agreement) unless it was lived in by one or both for more than 50% of that period

.

NZ residency & stranded in NZ (Covid)

Q: Slide 61....are we correct in thinking that if the stranded person in NZ does not have a re-entry visa (while stranded in NZ) for the country they will be returning to, that the Covid rules do NOT apply and the DTA arrangements will have to be worked through?

A: The IRD policy states:

> *Factors that may be considered in deciding if a person is practically restricted in travelling include both:*
>
> *1. Border controls or entry restrictions. A person is unable to practically leave New Zealand if they cannot enter a country of which they are a citizen or permanent resident or visa holder.*

For example, let's say the person came from the UK for a period of less than 183 days, but then got stranded due to Covid. The IRD policy means that if they are prevented from returning to the UK because the UK immigration has not given them a re-entry visa due to the UK restrictions, they will still be treated as non-residents even though they are in NZ for more than 183 days.

Q: Regarding John & Jill stranded during Covid, what about an exemption for transitional residents? if they own property in UK and have rent and a mortgage etc going on until they are able to sell the property.

A: John & Jill do not qualify as transitional residents as they have not been away from NZ for more than 10 years (they'd been away 5 years).

However this is a good point to note for other cases. Persons who qualify as transitional residents have an exemption on their foreign passive income for 4 years, such as an overseas rental property. And they won't be liable for NRWT on the foreign bank interest, nor FX gain/loss issues during the 4-year period.

Retained earnings and insufficient ICA

Q: Do non-deductible expenses need adjusting when calculating retained earnings for ICA credit purposes?

A: Yes they definitely do. This is one reason why there are excess ICs

Q: Insufficient IC's are also caused by overseas tax paid on royalties etc that can't be put into the IC account?

A: Absolutely – thanks for the reminder. Also a good reason to be an LTC where it is possible.

.

Julie Segedin (07) 282 0723 julie@jstax.co.nz

Carl Brandt (07) 282 0722 carl@carlbrandttax.co.nz