

NEWSLETTER

December 2020

CONTENTS

The Brightline Test – Residential Property 1
Asset Purchases – \$5,000 Threshold.....1
Interest – When is it Tax Deductible?.....2
Residential Tenancy Act .2
Trust Act 20193
New Tax Rate – 39% - Impact on Individuals and Company Shareholders ..4

Christmas Close Down Reminder

Our office will be closed for the Christmas break from Midday Tuesday 22 December 2020 and will re-open on Wednesday 13 January 2021.



Thank you for your support over the past year. We wish you a Merry Christmas and Happy New Year from David, Charmaine, Elaine, Gaylene, Karen, Kathryn, Pam and Tyler.

DB CHARTERED ACCOUNTANTS LTD

In this newsletter we cover the brightline test, asset purchases threshold, interest deductibility on residential rental properties, residential rental tenancy Act updates, the Trust Act 2019 and the increase in the top tax rate set for 1 April 2021.

THE BRIGHTLINE TEST – RESIDENTIAL PROPERTY

Under current law if a residential property changes ownership or is sold within 5 years, any gain on the value of the property is considered taxable income. This is regardless of your intention at the time of acquiring the property. The provision excludes the family home and inherited property.



To qualify for the main home exemption the property must be occupied for greater than 50% of the time that you have owned the property.

Some examples to illustrate:

Mum and Dad don't get to the beach house much these days and decide to sell (or gift) the property to their adult daughter. Four years later circumstances change and the daughter decides to put the property on the market. As this falls within the 5 years any gain on the property will be taxable.

Joe lives in Christchurch and has found that work is bringing him to Hamilton 3 days a week. In 2018 Joe decides to purchase a flat in Hamilton for when he is there on business. After all the uncertainty in 2020 Joe decides on a different career path. Joe no longer requires his property in Hamilton and sells it in 2021. Joe does not qualify for the main home exemption as he only lived in his flat in Hamilton 3 days a week or 42% of the time he owned the property. Any gain on the property will be taxable.

If a property sale is not a straight forward sale of the family home please contact us to discuss your residential property transactions before signing on the dotted line.

ASSET PURCHASES – \$5,000 THRESHOLD

A reminder that the threshold has been raised to allow the immediate expensing of assets that cost less than \$5,000 in the 2020-2021 income year. **This temporary increase for assets purchased ends on 17 March 2021.** After 17 March 2021 the threshold will reduce back to \$1,000. See our June 2020 Newsletter for further information.

INTEREST – WHEN IS IT TAX DEDUCTIBLE?

When considering whether the interest on borrowed money is tax deductible there are a few key points to consider. This is especially important if intending to purchase a new investment property – the ramifications of not getting an adequate tax deduction may cost additional tax over a number of years.

To determine if interest is deductible we must first look at what the funds borrowed were used for. The expense must have a nexus with income to be able to be claimed as an expense.

Section DA 1(1) of the Income Tax Act confirms that a person is allowed a deduction for an amount of expenditure or loss to the extent to which the expenditure or loss is:

- (a) incurred by them in deriving their assessable income or excluded income; or
- (b) incurred by them in the course of carrying on a business for the purpose of deriving their assessable income or their excluded income.

DA 2(2) confirms that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the private limitation.

For example in the case of *Borlase v CIR 53*, the husband and wife taxpayers moved from one city to another on account of the husband's work. They retained their former home, which was subject to a mortgage of \$23,326, and rented it out. They bought a home in which to live in the second city for \$185,000. They borrowed \$208,000 to buy the home and to refinance the mortgage on their old home. The mortgage was secured over both properties.

The taxpayers sought to deduct interest relating to both properties, arguing that by borrowing they retained their rental property. The judge ruled that the funds were used to purchase a private dwelling, the liability had not arisen in connection with income earning assets and therefore the interest was not tax deductible to the taxpayer.

If you are intending to purchase an investment property, contact us before a property is purchased and loans are in place, so we can discuss your situation to confirm how any related debt can be tax deductible against the rental income.

Hired a handy man and gave him a list. When I got home, only #1,3 & 5 were done. Turns out, he only does odd jobs!



RESIDENTIAL TENANCY ACT

As a reminder, there are recent and upcoming changes to the tenancy laws which all landlords should be aware of. The main points are noted below:

Phase 1: Law changes to take effect on 12 August 2020

- **Rent increases:** Rent increases are now limited to once every 12 months. Rent can also not be increased within 12 months of the start of a tenancy.

Phase 2: Law changes to take effect from 11 February 2021

- **Security of rental tenure:** Landlords will no longer be able to end a periodic tenancy without cause. A landlord may terminate a periodic tenancy by giving at least 63 days notice if the owner requires the premises for themselves or family (or employees) within 90 days of termination. A landlord may terminate a periodic tenancy by giving 90 days notice if the premises are to be put on the market or an unconditional agreement requires vacant possession. A landlord can still apply to have a tenancy terminated. This may include cases where – rent is 5 days in arrears more than 3 times in a 90 day period or where there is continued anti-social behaviour. All these steps require notices to the tenant on each occasion and adequate documentation. Tenants are still required to give 21 days notice in writing of their intention to vacate.
- **Changes for fixed-term tenancies:** All fixed-term tenancy agreements will convert to periodic tenancies at the end of the fixed-term unless the parties agree otherwise.
- **Making minor changes:** Tenants can ask to make changes to the property and landlords must not decline if the change is minor. Landlords must respond to a tenant's request to make a change within 21 days. Tenants are required to revert the changes back, when they vacate the property.
- **Prohibitions on rental bidding:** Rental properties cannot be advertised without a rental price being listed, and landlords cannot invite or encourage tenants to bid on the rental.

- **Fibre broadband:** Tenants can request to install fibre broadband, and landlords must agree if it can be installed at no cost to the landlord, unless specific exemptions apply.
- **Privacy and access to justice:** A suppression order can remove names and identifying details from published Tenancy Tribunal decisions if a party who has applied for a suppression order is wholly or substantially successful, or if this is in the interests of the parties and the public interest.
- **Assignment of tenancies:** All requests to assign a tenancy must be considered. Landlords cannot decline unreasonably. If a residential tenancy agreement prohibits assignment, it is of no effect.
- **Landlord records:** Not providing a tenancy agreement in writing will be an unlawful act and landlords will need to retain and provide new types of information including property details relating to the healthy homes standards and hold relevant records for at least 12 months after the termination of a tenancy.
- **Enforcement measures being strengthened:** The Regulator (MBIE) will have new measures to take action against parties who are not meeting their obligations. This includes the ability to impose infringement notices, penalties and fines.
- **Changes to Tenancy Tribunal jurisdiction:** The Tenancy Tribunal can hear cases and make awards up to \$100,000.

Phase 3: Law changes to take effect by 11 August 2021 (but may take effect earlier if the Government agrees)

- **Family violence:** Tenants who experience family violence will be able to withdraw from a fixed-term or periodic tenancy without financial penalty by giving two days' notice and evidence of the family violence. If they are the only tenant, the tenancy will end.
- **Physical assault:** A landlord will be able to issue a 14-day notice to terminate the tenancy if the tenant has assaulted the landlord, the owner, a member of their family, or the landlord's agent, and the Police have laid a charge against the tenant in respect of the assault.

TRUST ACT 2019

In our December 2019 newsletter we covered off the new Trusts Act 2019. This comes into force from 30 January 2021. This information is repeated below as a reminder to all Trustees.

Term of Trust

Historically the maximum term for a Trust was 80 years. This has been modified to 125 years. Some Trusts may already have a set final distribution date which will determine when it is to be wound up. Without a final distribution date the Trust will be able to continue for 125 years.

Mandatory Duties of all Trustees:

- Know the terms of the Trust
- Act in accordance with the terms of the Trust
- Act honestly and in good faith
- Act for the benefit of beneficiaries and permitted purpose of the Trust
- Exercise Trustee powers for proper purpose

“Default” duties - are other duties the Trustees must abide by unless permitted otherwise by the Trust terms.

These include duty of care, duty to invest prudently, not to exercise power for own benefit, not to commit Trustees to future exercise of discretion, duty to avoid conflict of interest, impartiality, not to profit and duty to act unanimously.

Recordkeeping

Every Trustee must hold a copy of the Trust Deed and any subsequent variation. Trustees are also required to ensure that at least one Trustee holds other Trust documents including records of the Trust assets and liabilities, records of trustee decisions, written contracts entered into, accounting records and financial statements, changes to Trustees, memorandum of wishes and any other relevant documents. Documents must be kept for the duration of the Trust.

Notifying beneficiaries of Basic Trust information

The basic information that is to be given to beneficiaries (aged 18 and over) includes the fact that the person is a beneficiary of the Trust, the name and contact details of the Trustee/s and the fact that the beneficiary has the right to request a copy of the terms of the Trust or “Trust Information”.

Trust Information is defined as “any information regarding the terms of the Trust, the administration, or the Trust property and any other information reasonably necessary for the beneficiary to have to enable the Trust to be enforced”. This information will only need to be provided when requested and will include a copy of the Trust Deed.

Being required or requested to provide the above information will not necessarily mean that a beneficiary is entitled to a copy of the financial statements as these do not automatically fall within the definition of Trust Information however the Trustees may need to consider this.



Presumption

Before releasing any "Basic Information" or other "Trust Information" Trustees must consider whether Trustees should release this information. Reasons for not releasing information include degree of a beneficiaries interest in the Trust, personal or commercial confidentiality, intentions of the settlor at time of Trust establishment, age and circumstances of the beneficiary, effect on trustees, beneficiaries, third parties, family relationships, nature and context of the request among other matters. If none of the above apply, trustees will be expected to proactively provide Basic Trust information and then other Trust Information when requested.

While the above will be the main changes for Trustees to consider there are also updated rules for appointment and removal of Trustees, termination of Trusts (including allowing consent by all beneficiaries), court powers and alternative disputes resolution process.

The above requirements will require Trustees to ensure they know the terms of the Trust Deed and ensure they are following these terms. Trustees will need to know where the Trust paperwork and documentation is held and will need to turn their mind to what information will be provided to beneficiaries and consider any reasons why information will not be provided.

NEW TAX RATE – 39% - IMPACT ON INDIVIDUALS AND COMPANY SHAREHOLDERS

The Government has passed legislation confirming that annual earnings of an individual taxpayer over \$180,000 will be taxed at 39% from 1 April 2021.

For an individual with earnings of \$250,000 per year this will mean extra tax payable of \$4,200.

The tax rate thresholds for individual income tax from 1 April 2021 will be:

Up to \$14,000	10.5%
\$14,001 to \$48,000	17.5%
\$48,001 to \$70,000	30.0%
\$70,001 to \$180,000	33.0%
\$180,001 & over	39.0%



In our September 2019 newsletter we covered off a shareholder "overdrawn current account". This is where the funds taken out of the Company by a shareholder are more than the profit that has been allocated to them. In these cases the Company is required to charge interest at 4.5%. To avoid this a dividend can be declared to shareholders.

We would recommend that shareholders assess the likelihood of requiring Company funds, the impact of the 39% individual tax rate and whether a dividend should be declared.

Any dividend declared prior to 31 March 2021 will be taxed at 33%.

A dividend declared after 1 April 2021, that takes an individual shareholders annual earnings over \$180,000, will be taxed at 39%.

Remember that a dividend declared of \$100,000 becomes a taxable dividend of \$139,000 after allocating Imputation Credits. If a shareholder also receives a salary, earnings can easily get the \$180,000 level.

IMPORTANT TAX DATES

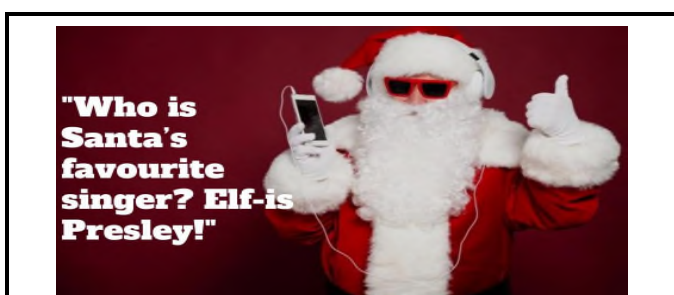
15 January – 2021 provisional Tax Due (2nd instalment) October/November GST Return Due

7 February – 2020 Terminal Tax due (if no extension of time with IRD)

28 February - December/ January 2021 GST Return Due and Provisional Tax due for GST Ratio option taxpayers.

31 March – Final day for Ratio option Provisional Tax applications.

7 April - Final date for 2020 Terminal Tax due.



If you would like to discuss anything mentioned in our newsletter please contact us at:

DB Chartered Accountants Limited.

E-Mail: office@dbchartered.co.nz

Phone: (07) 847 8154

Website: <https://www.dbchartered.co.nz>