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Tax Update

Mixed Use Asset Rules. *(From 01 Apr 2013).*

We outline below the application of the New Mixed Use Asset Rules that will come to effect from 01 Apr 2013.

APPLICATION

The newly introduced rules apply to assets that are used for private and income earning purposes. These will generally cover boats, aircrafts, batches and the like.

INCOME TAX - Application from beginning 2013-14 income year

- The new rules will apply to assets (comprising of land or asset that costs more than $ 50K) that are used to earn income and that are also used privately and are NOT used for more than 62 days in the year. The new rules will apportion the expenditure on the basis of actual income earning use divided by the total actual use of the asset.
- The rules will apply on asset by asset basis. So for example if you would have two planes then you would have to track them separately.
- The new rules will apply to assets held in various structures close companies, look through companies, trusts, partnerships and by individuals, regardless of whether market rental is paid for the use of the asset. Private use is defined as a use by the person or anyone associated with that person. For the purposes of the mixed use rules a person is associated with a company if the person has a voting interest in the company of 5% or more, or the person's share gives them the right to use the asset. These new rules override the general associated persons rules. Their aim is to obviously catch as many of these transactions as possible.
- Certain expenditure will not need to be apportioned. This will generally include depreciation and other expenditure insofar as it is incurred solely for the use of an asset for purposes of deriving income or if it is an expenditure from which a person could not derive a personal benefit such as meeting annual regulatory and licencing requirements. (Annual aviation survey and licencing costs, advertising).
- General expenditure from which a person can benefit will include for example repairs and maintenance, interest (excludes currency fluctuations) and other general costs which will have to be apportioned.

APPORTIONMENT FORMULAS FOR EXPENDITURE

$$\text{Expenditure} \times \frac{\text{income earning days}}{(\text{income earning days} + \text{private days})}$$

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APPORTIONMENT FORMULA FOR INTEREST

There are complex interest apportionment methods for groups of companies and layers of shareholders. Apportionment of interest for close companies (being NZJet Charters) will depend on whether the debt exceeds the value of the cost of the asset or not.

- **If debt value is less than the cost of asset**

Interest expenditure x [(income earning days/ (income earning days+ private use days))

- **If debt value exceeds the cost of an asset**

Interest expenditure x (Company's asset cost/ Company's Debt in relation to that asset)

LOSSES – RING-FENCED

- The quirk, intention of these new rules is that losses will be ring-fenced if the gross income from the asset, excluding income from associated persons, is less than 2% of its cost. In this case, the expenditure / loss, calculated in accordance with the above formula, will be able to be carried forward and offset against future profits from that asset.

GST – GOODS AND SERVICE TAX

- There are already complex GST rules in place which require an adjustment to be made on annual basis for the private us of an asset. These rules will further be modified with effect of 2013/14 income year.
- Owners of mixed use assets will be required to apportion their input deduction in a way that reflects their relative taxable and non-taxable use of the asset. These rules will be aligned as close as possible to the income tax treatment, with some modifications.
- GST apportionment rules will apply to the input claimed at the time the asset is acquired and will equally apply to the GST inputs claimed in relation to the expenditure.
- Furthermore, a GST registered person will have to perform an annual calculation to determine the level to which GST can be claimed this annual wash up calculation will allow the registered person to either claim further GST input tax credit or will be required to return further output tax credit to the IRD.
- The actual use of the asset for taxable supplies (% of use) must be estimated at the time of acquisition. The method of estimation must not be arbitrary but based on reasonable estimation, i.e. log book, industry practice, etc.
- At each adjustment date (annually) GST registered person must compare the actual % of use with
    - The intended/estimated use (if no previous adjustment was made), or
    - The previous actual use (if previous adjustment was made)
- GST adjustment will need to be made if the % of use is 10% or greater, or if the value of the adjustment exceeds $ 1,000.

ADJUSTMENT IN RELATION TO EXPENDITURE

Formula

$$\text{GST Input tax} \times \frac{\text{total income earning days}}{(\text{total income earning days} + \text{total private days})}$$

Example

If a taxpayer claims $ 200,000 (being 100%) of GST inputs during the year, and finds out at the end of the year that the business use was 70% only, the taxpayer will have to return the 30% ($ 200,000 x 30% = $ 60,000) over claimed GST back to the IRD.

GST that claimed that relates solely to business in relation to regulatory requirements does not need to be apportioned (annual aviation licences, etc).

ADJUSTMENT IN RELATION TO GST INPUT ON ASSET ACQUISITION

- As with the general apportionment rules the new rules will require the registered person to perform an annual calculation to determine the level to which they can claim input. As with the income tax rules no apportionment is required for input tax that relates solely to the income earning use of an asset.
- Whilst there has been no adjustment formula published for the annual adjustments it will be closely aligned to the ordinary adjustment rules. Based on the ordinary adjustment rules the situation will be as follows:
- Number of Maximum adjustment periods will be capped by the value of the asset (does not include land)
    - $5,001- $10,000 2 adjustments
    - $10,001 - $500,000 5 adjustments
    - $500,001 + 10 adjustments
- Adjustment period is generally the financial / income tax year.
- The actual use of the asset for taxable supplies (% of use) must be estimated at the time of acquisition. The method of estimation must not be arbitrary but based on reasonable estimation, i.e. log book, industry practice, etc.
- At each adjustment date (annually) GST registered person must compare the actual % of use with
    - The intended/estimated use (if no previous adjustment was made), or
    - The previous actual use (if previous adjustment was made)
- GST adjustment will need to be made if the % of use is 10% or greater, or if the value of the adjustment exceeds $ 1,000.
- Same apportionment formula is used here it is just that the change in % of use is compared year on year and appropriate adjustment made.

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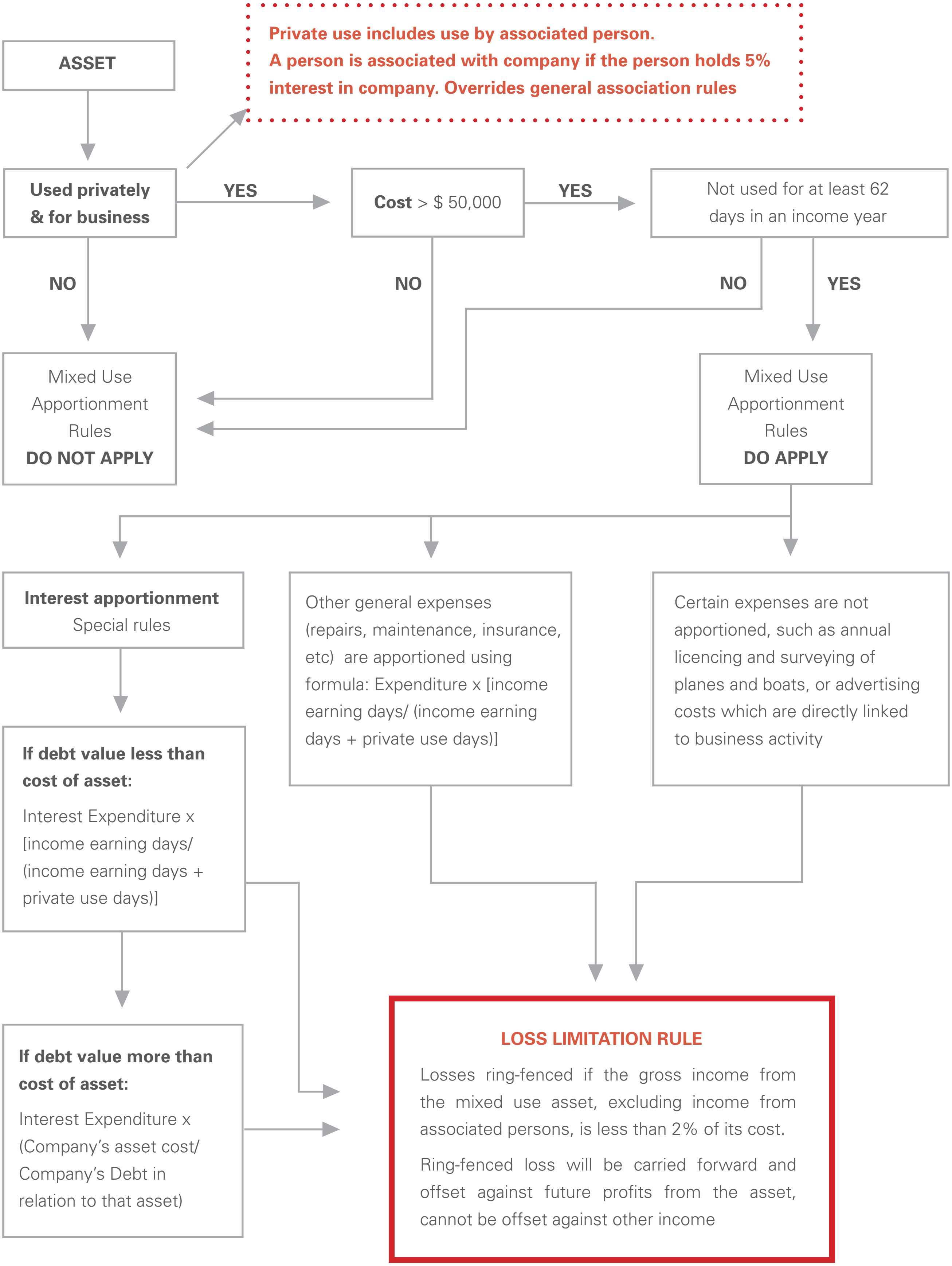
MIXED USE ASSETS - FLOW CHART

(Applies to all kinds of ownership structures)



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Covisory Partners recognises that everyone is different. We work closely with our clients to understand their requirements today and their aspirations for the future.

There's no 'one size fits all' about our services. We will tailor a solution to fit you personally, drawing on our up-to-date specialist knowledge and our years of experience.

Our clients tell us that they value our commercial experience and our ability to cut through to the heart of the matter. They appreciate our strategic insight and they value our ability to come up with creative solutions to difficult problems. They are reassured by our grasp of the technical detail – based on years of experience, together with the latest research. They rely on us to maintain oversight of their strategy implementation and to let them know when they've drifted off course. And they enjoy our fresh, straight-forward approach.

We pride ourselves on giving you specialist commercial and taxation advice in everyday language. We keep it simple. We don't beat around the bush.

We understand the technical issues, and we use plain English to make sure you understand them too, so you can make sensible, well-founded decisions about your business, your family, and your future.

We are Chartered Accountants and members of NZICA, so you can be assured that our advice is dependable.

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