Tax Working Group Information Release

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This paper has been prepared by a member of the Tax Working Group for consideration by the whole Tax Working Group.

The advice represents the preliminary views of the member who prepared the paper and does not necessarily represent the views of the whole Group or the Government.

Capital Gains Tax

Subgroup stocktake

What is taxable?

- Tax gains on identified taxable assets
  - Clearer what we are taxing
  - We have rules for many items already
  - Lower compliance and administration costs
- Work to do
  - Family home definition

Assets we are considering making taxable

- Land (including buildings). Includes
  - Residential rental
  - Commercial
  - Agricultural
  - Industrial
- All business assets – depreciable property, intangible IP and goodwill
- Interests in equity (shares, PIEs, Kiwisaver) – subject to further work

Personal Assets

- We propose to include:
  - Baches
  - Vacant land
- Question about how far to go with other assets
  - Collectibles (rare coins, stamps, art)
  - De minimis asset value might be useful to target high value collections

Assets to which we would not extend a CGT

- Financial arrangements
  - Happy with current accrual treatment
- Open question about foreign investment fund (FIF) and controlled foreign company (CFC) regimes.

Assets/payments that we are not considering

- Other income/gains not now taxed should be taxed under ordinary rules by necessary amendment if appropriate
  - E.g: employee hurt and humiliation payments
  - Damages and payments for contractual loss
- Offshore residential land (and loans associated with that asset) should be outside the tax base.
  - Assumption that NZ gets no (or maybe only little) net tax revenue
  - This is being tested with further work.

Recommendation 1

- **Agree** with the approach to what we do and do not make taxable.
- **Indicate** whether personal assets should be limited to baches + vacant land, or include collectibles and other personal assets with asset and collection value de minimis.

De minimis

- No general de minimis
- Probably for personal assets if taxable.

Recommendation 2

- **Agree** that there be no de minimis for the amount of gain, but that a de minimis asset value for personal assets is likely warranted.

When is tax due?

- When an interest in a taxable asset is realised.
- Deemed realisation for market value of taxable assets (excl. NZ land – still in the base) on emigration from NZ.
  - Consider rule (as in Australia) whereby a person a migrating person can elect to defer tax until the asset is sold
  - Mirror rule for immigration to NZ (deemed acquisition of market value as cost base)
- Deemed realisation when taxable asset is destroyed
- Consider case when significant damage or loss relating to property (e.g. seismic strengthening costs and leaky building issues).

Recommendation 3

- **Agree** that tax would be due on realisation.
- **Agree** that there be deemed realisation on emigration and immigration to provide a deemed sales price and deemed acquisition cost respectively.
- **Agree** that death and gifting are realisation events but may be subject to rollover
- **Agree** deemed realisation when asset is destroyed
  - Insurance proceeds are considered under rollover relief

Rollover relief

Event	Rollover relief or not? (secretariat view)	Rollover relief or not? (subgroup view)	Notes
Compulsory acquisition by the state	Yes	Yes	Provided new asset is still in the tax base
Insurance or other proceeds	Yes	Yes	Only relevant if there is a gain (that is, insurance proceeds are greater than cost base). Rollover provided new asset is still in the tax base
Same asset and ultimate economic owner	Yes	Yes	
Asset-class specific – active business premises (including farms)	No	[No consensus as yet]	
Asset-class specific – all other assets	No	[Majority says no so far]	
All other reinvestment (i.e. not asset-class replacement)	No		
Death (surviving spouse or partner)	Yes		Unless surviving spouse is non-resident (if it is possible to have a non-resident spouse or partner)
Death (all other bequests)	Yes, for operating businesses and other illiquid assets		
Gifting	Yes, for operating businesses and other illiquid assets		

Recommendation 4

- **Note** that rollover is still under consideration by the subgroup
- **Decide** whether to have rollover on death for all assets, or illiquid assets only (with exactly what “illiquid” covers to be decided later, but it would cover operating businesses)

Calculating the gain

- Realisation price – acquisition price + capitalised costs
- For personal assets, capitalised costs are those that would not have been deductible if the asset had been a non-personal asset.

Recommendation 5

- **Agree** that the amount subject to tax is the realisation price – acquisition price + capitalised costs
- **Agree** that for personal assets (e.g. bach) capitalised costs are those that would not have been deductible if the asset had been a non-personal asset (e.g. does not include repairs and maintenance, but does include improvements).

Transition

- Valuation day
- “Smoothing” (median rule)
- Need rule for when assets formerly not taxable become taxable (e.g. family home becomes rental)
  - Could use rateable value, but exploitable.
  - Loss ringfencing or deny deduction for losses when RV rule applies.

Recommendation 6

- **Agree** that gains from "valuation day" are the relevant gains.
- **Agree** a smoothing or median rule [explained more fully in accompanying Secretariat paper]
- **Agree** for specific valuation rules when assets come in and out of the tax base (e.g. family home->rental->family home) to prevent abuse

Treatment of losses

- General rule is that losses on taxable assets offset against any other income
- Will not apply to portfolio shares. Losses ring-fenced to other share portfolio gains (not clear if includes dividends)
- Losses on personal assets (including holiday homes) either ringfenced to other similar losses or no deduction.
  - Losses could well represent private consumption

Recommendation 7

- **Agree** with principle that where possible, losses should be offset against any other income
- **Agree** that where assets are liquid, losses are ringfenced to gains from that asset class
- **Agree** that losses on personal assets are either
  - Ringfenced to gains on other personal assets, or
  - Denied any deduction

Rate of tax

- Ordinary marginal rates
- No indexation
- Revisit after retirement discussion to make consistent.

Recommendation 8

- **Agree** that the rate of a CGT should be ordinary marginal rates, noting the PIE accrual question later, and noting further work on administration
- **Agree** no indexation for inflation
- **Agree** that this needs to be reconsidered if any changes to retirement savings.

Equity interests and double tax

- Not a problem at SME level because special dividends or taxable bonus issues can be paid
- Realised gain at company + realised gain on shares = not a big problem given low imputation balances
- Unrealised gain at company + realised gain on shares
  - not a problem if gain never realised at company level
  - if sold soon after it does create double taxation.
- PIE issues still being worked through

Double losses

- As with gains, but special rule to prevent orchestrated manipulation (specific anti-avoidance rule)

Recommendation 9

- **Note** that double tax/double losses issues are still being worked through.
- **Note** that the subgroup are exploring options for PIEs, including taxation on accrual with a lower rate as compensation.

Maori interests

- Questions about degree of rollover/exemption for:
  - Maori entities
  - Maori-specific assets