
Client Newsletter

December & January 2009/2010

IRD Matters

New Mileage Rate for Motor Vehicle Expenditure

The Commissioner of Inland Revenue (CIR) is required to set a mileage rate that can be used by taxpayers to calculate the expenditure or loss on a motor vehicle. The mileage rate calculation represents the proportion of business use of a motor vehicle.

The CIR last revised them in 1996. However, it will review the mileage rate at least once a year to ensure taxpayers are not disadvantaged by any significant change to overall vehicle running costs.

The new mileage rate set for motor vehicles for the 2008-2009 income year is 70 cents per kilometre (up from 62 cents/km).

Filed Tax Returns

Now that we are under a self-assessment regime, taxpayers take a tax position the moment they file their tax returns with the Inland Revenue Department (IRD). This means that if an error is found subsequent to filing the tax return it cannot be simply amended, as was the case under the old regime where the IRD used to assess the tax return filed by the taxpayer.

The only option available for the taxpayer is to request the IRD to amend the tax return under section 113 of the Tax Administration Act 1994 (TAA). S 113 of TAA states that the "Commissioner may...amend the assessment as the Commissioner thinks necessary in order to ensure correctness...".

The mileage rate applies in respect to:

- Self-employed taxpayers
- Up to a maximum of 5,000 kilometres of work-related travel each year
- Motor vehicles irrespective of engine size whether they are powered by petrol or diesel

This mileage rate doesn't apply to use of motorcycles.

In addition, employers may use the mileage rate as a reasonable estimate to reimburse employees (including shareholder-employees) for the business use of an employee's vehicle.

Alternatively, employers can choose to use the New Zealand Automobile Association rates, which are usually higher, to reimburse its employees.

The IRD appears to be more accommodating in situations where the amended tax return results in more tax to pay than the original filed one. This also often results in the imposition of use of money interest and shortfall penalties.

However, in a reverse situation where the taxpayer has filed an incorrect tax return resulting in overstated tax payable, the IRD as been known to emphasise and act on the "*may amend*" part of the section rather than "*to ensure correctness*".

In such cases, the only remedy available to the taxpayer is to start the dispute process, which comes with its own timelines, rules and thus costs.

Tax Issues for New Zealanders Returning from Overseas

It is important that New Zealanders who return from overseas know that once they become New Zealand tax residents again they are taxed on their worldwide income. If they have income earning assets overseas they should seek professional advice early.

There is a temporary exemption from returning foreign income for those who have been non-residents for at least 10 years before their arrival in New Zealand. This exemption can only be granted once in a lifetime.

The foreign income would be exempt for a period of 4 years from the time the taxpayer qualified as a New Zealand tax resident. The exemption cannot be extended or renewed after its expiry date. (This exemption also applies to new migrants when they become New Zealand tax residents).

The main issues to be aware of are:

- Shares held in foreign companies, as the foreign investment fund or controlled foreign company rules may apply.
- Distributions from trusts - if the person regains residency within five years of ceasing then the distributions during the period of non-residency may be taxable in New Zealand.

Interests in foreign pensions, life insurance policies or superannuation schemes may create tax obligations in New Zealand.

Tax Treatment of Holiday Houses

Generally, under section CC1 of the Income Tax Act 2007, if you own a holiday home and rent it out the rental income derived is taxable. This section taxes all rental income received from the leasing of land (including any house on that land).

There are no hard and fast set of rules that lay out the tax treatment of holiday houses rented out. Each case is considered on its particular circumstances. However, the following general principles may assist in ascertaining the taxability of rental income and deductibility of expenses.

1. If the owner derives any rental income from his holiday house, it is taxable income whether or not the rental is charged at market rates or whether there is a business activity being carried on.
2. Expenses incurred in relation to the rental activity (such as interest, insurance, rates, depreciation, etc.) may be deductible if there is a nexus between the two.
3. If the holiday house is rented out for only a part of the year, a proportion of the expenses incurred may be allowed as a deduction if there is a sufficient connection with the income earned.
4. If the owner rents it out for a long term, say 6 months of the year, to a tenant at arm's length then the owner is most likely be able to claim expenses related to those six months such as rates, interest, insurance, etc.
5. There has to be a strong evidence of its availability, be it for limited periods or throughout the year, by way of active and regular marketing at market rates to promote it and attract tenants. If the owner indicates that his house was genuinely available for earning rental income over a period of time then expenses incurred for that corresponding period are potentially deductible.
6. If a holiday house is available for renting out to third parties only for a limited time (in other words, the owner wants to use for himself and his family and friends) then the Inland Revenue will apply the following:
 - The owner is not entitled to claim a deduction for expenses incurred for the periods the holiday house is not rented. These are considered of private nature.
 - Where the friends or family are making contributions towards the owner's expenses for the use of the holiday house, i.e. they are not charged rent, then the payment will not be considered rental income. As a result, no expenses will be allowed as a deduction.
 - If the holiday house is used as a genuine income-earning asset then the owner can claim a proportion of the expenses incurred which equal to the time the holiday house was actually rented.
 - Where parts of the house are not available for use by the tenant, e.g. locked rooms storing the owner's personal possessions, then the deduction is allowed only for the portion of the house that is available for renting out.

To sum up the above, if the holiday house is available for market rental for 50 weeks of the year then the deductible expenses would be for 50 out of 52 weeks. If the house is only available for 2 weeks then the expenses deductible would be 2 out of 52 weeks. Where the house is let to a friend at "mates rates" then the expenses for that period are limited to the amount of rent received. If the friend only makes a contribution towards the owner's costs for the use of the holiday house, then the amount received is not considered to be income and consequently no deductions are available to the owner.

Where the holiday house is used both for private purposes and to derive rental income, the ability to deduct expenditure will be assessed on a case-by-case basis depending on the genuine availability of the holiday home for earning rental income.

Independent Earner Rebates

Please note there was an unintended error in our last newsletter regarding State assistance. New Zealand Superannuation is included in State assistance— i.e. a qualified taxpayer will not receive this rebate if he/she receives New Zealand Superannuation payments.

Important: This is not advice. Clients should not act solely on the basis of the material contained in the *Client Newsletter*. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The *Client Newsletter* is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval. 187/09.