

Taxman hits back hard at “mixed use assets”

The bill containing the legislation to change the way mixed use assets are taxed has been given the green light by the finance and expenditure committee and now awaits formalities before becoming law. The legislation takes a D9 dozer to pull a nail approach and is a dense 30 odd pages long. However, while it may be good for insomniacs and people in Wellington needing to paper over holes in the wall caused by last week’s storm, the impact of the legislation contains a real bite.

So what is a mixed use asset? The starting point is that a mixed use asset can only be land (including any dwellings), and boats and aircraft that cost in excess of \$50,000. To be a mixed use asset, the asset must be used by a person in an income year partly to derive income, partly for private purposes and not used for at least 62 days in the year.

The definition is trying to target those people who own a holiday home, boat or aircraft and use it for private purposes and also rent the asset to other users. Under the previous rules, the expenditure relating to the rental use was deductible as well as the expenses relating to the period of time when the asset sat idle but was “available for rental”. In many cases, by renting what is otherwise a private asset, people were able to generate tax losses for the expenses incurred – particularly the expenses incurred when the asset was sitting idle. It is these expenses that are the real target of the rules.

Private use is defined as use by the person that owns the asset or by an associated person. Private use also arises if the mixed use asset is used by a person (whether the owner, an associate or not) when income derived from the use of the asset is less than 80% of the market value.

So, for those assets caught by the rules, two examples illustrate when the rules apply.

- Bob purchases a new boat and moors it at Stewart Island. Bob hires the boat to visitors to the Island and uses it to take family and friends fishing. When it is not in use Bob advises the information centre that it is available for hire. Private use also arises if Bob lets his brother use the boat, or Bob hires it to a friend at a discount of greater than 20% off his advertised rate.
- John owns an aircraft that is housed at the Te Anau airport and used from time to time by John and his family, and also by members of the local aero club. John receives a payment for the use of the aircraft.

There are exceptions to these rules. One of the main exceptions applies when the main use of the asset is in a business that is not a rental business and private use is minor. In this case, as long as fringe benefit tax or income tax is paid for the private use the rules will not apply.

So what do the rules do? The rules apportion expenditure relating to the asset on the basis of income earning days as a proportion of both income earnings days and private use days. Thus, in the example above, if Bob used his boat for 30 days in a year and hired it out for 90 days, only 75% of the expenditure would be deductible. However, as the ad goes, that is not all. Along with this package comes apportionment of input tax credits for GST, deemed dividends to company shareholders, denial of interest deductions in related group companies (to the value of the asset), and potential quarantining of any loss relating to the asset.

A real sting could be the way the denial of interest deductions works. If the mixed use asset is in a company, interest deductions are denied to the value of the asset no matter which group company has the debt and no matter if the debt does not relate to the asset.

In short – if you have one of these assets in a company – get it out.

The rules apply to land (holiday homes and the like) from 1 April 2013, but for boats and aircraft, the rules apply from 1 April 2014. The extra year allowed for boats and aircraft is to allow time for people to get these assets out of the company. Concessionary rules make this a relatively painless exercise.

People who think they may be caught by these rules should seek advice earlier rather than later. And please, spare a thought for you poor adviser who has to wade their way through the detail.