Investment Tax Traps / Tips

1. The type of entity that holds investments has an impact on the tax payable because of tax rates and because of specific rules that only apply to certain types of entities.

2. Using a Company to hold investments caps the tax rate to a flat rate of 28%. However, further tax will be payable on distribution of profits to shareholders if the shareholders have higher marginal tax rates.

3. In most cases, holding investments in a company will not be tax efficient to shareholders who are tax resident outside of New Zealand. Where a New Zealand company pays income tax, it gets a credit called an "imputation credit". These credits can be attached to dividends which has the effect of lowering the tax payable on the dividend for a New Zealand tax resident shareholder. Non-resident shareholders do not get the benefit of an imputation credit so the income that the company has earned ends up being double-taxed by the time the profits reach the shareholders.

4. Income from investments (other than shares) has to be returned on an accruals basis, rather than when received, where the total value of financial arrangements held by the taxpayer exceeds $1m, or income from investments exceeds $100,000 or the difference between Accrual and Cash income is greater than $40,000.

5. Taxpayers on a tax rate of greater than 28% may be able to reduce tax on investment income by investing in a PIE. There is no benefit in a company holding investments in a PIE.

6. The "capital gain" on the sale of Government bonds, Capital Notes etc is taxable.

7. Generally, investments in shares in non-New Zealand companies that are not listed on the Australian Stock Exchange (ASX) are subject to tax on 5% of the opening market value each year, instead of dividends actually received or changes in value of the shares. However, individuals and family trusts have the option of paying tax on the actual return for the year (both dividends and capital gain in NZ dollar terms) if this is less than 5% of the opening market value but cannot claim a loss if total return is negative.

   Individuals and trusts are exempt from the above if total "foreign" investments cost less than $50,000 at all times during a tax year.

   Ideally, non-New Zealand/Australian shares should not be owned by a company (as a company has to return 5% of opening market value as income).

   For successful share traders who trade in foreign shares that are not listed in Australia on the ASX, these rules can be an advantage as income from trades is calculated under these rules rather than on the actual gains. However, losses cannot be claimed when trades go badly.

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8. The question of who is considered to be a share trader depends on the facts of each case; the number of times you buy and sell shares and the amount of time involved are critical factors.

   If you are in the unfortunate position of making a loss on shares then being a share trader can be an advantage as a loss against other income, which softens the blow of the loss to an extent. Although note the discussion for non-NZ shares in the preceding paragraph.

9. If you have foreign investments (not shares) you may be required to account for unrealised foreign exchange gains/losses – once again taxpayers with less than $1m of investments do not have to account for exchange gains/losses until the investment matures.

10. Inland Revenue considers that gold bullion and cryptocurrency as "personal property" that is held for resale in almost all circumstances, so they will expect any profit or losses on these to be taxable.

11. Trusts are taxed at the flat rate of 33% of income that the trustees retain. However, the trustees can choose to allocate income to beneficiaries instead and then the beneficiaries are taxed at their marginal rates (which may be as low as 10.5% or even nil if they have losses). The Inland Revenue have confirmed that the trustees are entitled to consider the tax implications/benefits while deciding to make distributions, so long as there is no artificiality.

    It is important to note that income distributed to a child (under 16) from a Trust is subject to a minimum tax rate of 33%. However, this the 33% rate does not apply if the Trust is created by Will (and Trust has not received any other assets by way of interest free loan or gift).

12. **Property Investment** we discuss specific issues for rental properties in our article "Tax on Rental Properties". However, we note the following mistakes are common for property investment:

    a) not identifying chattels separately and thereby missing out on an enhanced depreciation benefit.

    b) paying tax on depreciation recovered when a building is sold without identifying whether it is the land or buildings which have increased in value.

    c) forgetting that interest is only deductible on funds borrowed to directly buy the investment property (note interest deductions are being phased out for most residential rental properties from 1 October 2021).

    d) forgetting losses incurred from 1 April 2019 on a residential rental can't be offset against other income.

    e) Not appreciating when GST does (commercial properties including AirBNB) and doesn't apply (long-term residential rentals).

    f) Not appreciating when the sale of a rental property will be caught and taxed by the "bright-line" rules or other relevant taxing rules.

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13. **Individuals shifting to New Zealand after 1 April 2006**

Individuals who move to NZ after 1 April 2006 and have not been a tax resident in the previous 10 years are entitled to a 4-year tax exemption on most income derived form overseas. See separate article – tax Issues for Non-Residents.

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