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Our ref: KPMG Taxation (annual Rates for 2019-20 GST Offshore Supplier registrati.._.docx

The Chair
Finance and Expenditure Committee
Parliament Buildings
Wellington

28 February 2019

Dear Sir

KPMG submission – Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill ('the Bill")

KPMG is pleased to make a submission on the Bill. Our focus is on the GST and loss ring fencing rules.

GST on low-value imported goods

We support the policy of applying GST to low value goods imported into New Zealand. However, we note that the "supplier model" proposed is not the only model and that it imposes costs and obligations on parties who are not the supplier. We understand the reasons for this choice so have not in these submissions explored the alternatives. Our submissions are focused on ensuring as far as possible that the rules proposed have the desired outcome and that they do not interfere, as far as possible, with the flow of goods to consumers.

Summary of submissions

- That the proposed section 10(7D) of the Goods and Services tax Act 1985 ("GST Act") be amended to make it clear that the consideration on which GST will be calculated is net of any discounts provided by a marketplace operator.
- That provisions be added to allow for Commissioner discretion in:
  - agreeing with a registered person alternative requirements to the information prescribed under the new section 12(1B) of GST Act; and
  - agreeing with a registered person an alternative set of information to be included in a receipt for the supply of low-value imported goods (as prescribed by the new section 24BAB of the GST Act).
- That the list in the new section 60G(1) of the GST Act be an inclusive, not an exhaustive list of situations where a marketplace operator or a redeliverer will not be liable for GST on supplies of low-value imported goods, where it has relied on incorrect or misleading information provided by an underlying supplier.
- That the requirement for a marketplace operator to obtain a declaration from the underlying supplier of their residency be removed from the new section 60G(2)(a)(iii).

- That section 60G(5) be amended to include the location from which the goods are shipped from as one of the items of information that a marketplace operator can rely on in determining the residency of the underlying supplier.
- That the rules provide flexibility where possible, to allow affected businesses to comply with the new rules in the most cost-efficient way.
- That the drafting of section 12(1B) of the GST Act is amended to so that the information required shows who is charging GST and the rate of GST charged, rather than accounted for.
- That it is made clear that section 12(1B) only applies to distantly taxable goods and that clarity is provided on the application of the low value goods threshold after the new rules apply.
- That a refund for double taxation under section 12B is paid by Customs or the IRD, and not the supplier.
- That the proposed amendments to section 20H of the GST Act are revised to cover taxpayers who do not principally make taxable supplies at the time of capital raising (for example start-up businesses).

Ring Fencing

We responded to the Officials paper. We considered that the ring fencing rules are bad tax policy. We continue to be of that view. They deal with the symptoms and not the perceived causes. Our submissions however take into account the decision to proceed to introducing the proposals in Bill form.

Summary of submissions

- The loss ring-fencing rule is being introduced as the capital gain is not being taxed. As the Tax Working Group has recommended that a capital gains tax is introduced we recommend that the decision on whether the loss ring-fencing rules should be introduced should be deferred to after the Government has confirmed whether it intends to introduce a capital gains tax.

- The loss ring-fencing rule be modified so that it only applies to interest expenditure.

- New section DB 18AE is revised so that the main home exclusion is expanded to include persons who are temporarily overseas and rent out their home.

- An exclusion is introduced so the loss ring-fencing rules do not apply to non-New Zealand rental properties

- The interposed entity rules are modified so that an interposed entity can offset ring-fenced losses if they derive income that is related to residential rental property income.

- If the loss ring-fencing rules are introduced we recommend that they should be phased in over 5 years in accordance with the original election policy.

Detailed technical submissions

The Appendix contains our more detailed submissions.

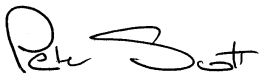
Further information

KPMG would like to appear before the Committee in support of our submission.

Should the Committee have any questions on the matters raised in this letter please contact us, John Cantin on 04 816 4518, or Peter Scott on 09 367 5852.

Yours sincerely

John Cantin
Partner



Peter Scott
Partner

GST on low-value goods

Discounts provided by marketplace operators

KPMG submission

The new section 10(7D) of the Goods and Services Tax Act 1985 ("GST Act) (per clause 12 of the Bill) should be reworded to reflect the policy intent, i.e. that the marketplace operator is only required to return GST on the actual amount paid by the consumer (net of any discounts provided by the marketplace operator).

Comment

The new section 10(7D) of the GST Act provides that:

"Where an operator of a marketplace makes a supply of remote services or distantly taxable goods to a recipient under ***section 60C or 60D****, the consideration for the supply does not include the amount of a reduction, made by the operator, in the price of the supply for the recipient if the amount of the reduction would otherwise form part of the consideration for the supply." [Emphasis added]*

The commentary on the Bill is clear that the intention of section 10(7D) is that where a marketplace operator provides a discount to a consumer, the marketplace operator would only be required to return GST on the discounted price (being the actual amount paid by the consumer for the goods purchased). However, it is unclear whether this policy intent is achieved by the current wording of section 10(7D). The phrase "does not include the amount of a reduction" in section 10(7D) is ambiguous and can be read to mean either:

- That the consideration is the gross amount payable by the consumer, i.e. that you do not take out/include the reduction provided by the marketplace operator from the consideration; or
- That the consideration is the net amount payable by the consumer after taking into account the discount.

We suggest that the wording be amended to make it clear that the consideration on which GST will be payable by the marketplace operator is the amount, net of any reduction/discount provided by the marketplace operator.

Preventing double-taxation

KPMG submission

Section 12 of the GST Act should include a provision allowing a registered person to agree with the Commissioner, an alternative approach on what information will be required to be included with the imported goods on importation so that New Zealand Customs Service ("NZCS") will not charge GST at the border.

If our above submission is accepted, then a provision should also be added to the proposed new 24BAC of the GST Act (per clause 24 of the Bill) that refers back to the agreed approach under Section 12 of the GST Act.

Comment

The new section 12(1B) of the GST Act requires the following information to be included with the goods at the time of importation to enable NZCS not to charge GST at the border:

— the name of the registered person accounting for the GST on the supply of the goods; and

— information on what the imported item is; and

— the rate of tax accounted for by the registered person.

The information is intended to enable NZCS to confirm that GST has already been accounted for on the supply of the imported goods and as such, no GST is required to be collected at the border. With this in mind, we submit that there should be discretion for the Commissioner to agree an alternative approach to show that GST has already been charged on the supply.

Some of the benefits of having this discretion are:

— It will allow businesses to agree with the Commissioner an approach that is most cost efficient and least disruptive to their business (and also the flow of goods at the border) while still satisfying the purpose of section 12(1B).

— It builds flexibility in the rules to allow for alternative approaches to be agreed as advances in technology develops more efficient ways to verify that GST has already been accounted for on the supply of an imported good.

As an example of an alternative approach, we are aware that in Australia, the Australian Tax Office has agreed with some marketplace operators that having the marketplace operator's label/sticker (which has the marketplace's GST registration number) on the imported parcel was sufficient to show that GST has been accounted for by the marketplace operator.

Under the new section 24BAC, a registered person is required to take reasonable steps to ensure that the following information are available to NZCS at the time of importation of the goods:

— the registration number of the registered person

— information indicating the items included in the supply, or imported with the supply, for which the amount of tax charged is more than zero and the rate charged for each of those items

— information indicating the items included in the supply, or imported with the supply, for which the amount of tax charged is zero.

If our above submission is accepted, then 24BAC should also include a provision that the registered person is deemed to have met its obligations under this section, where it has complied with the requirements of the alternative approach agreed with the Commissioner under section 12 of the GST Act.

Information available to avoid double taxation

KPMG submission

We suggest that the words "accounting" and "accounted" in proposed sections 12(1B)(a) and (c) are replaced with the words "charging" and "charged" respectively.

Comment

Customs would not collect GST on distantly taxable goods where GST has already been charged by the supplier at 15%. Customs requires specified information on importation for this to happen – specifically:

- the registered person supplying the item;
- identification of the item and

- the rate of tax.

For the first and third requirements, proposed sections 12(1B)(a) and (c) refer to "the registered person who is accounting for the tax" and "the rate of tax accounted for by the registered person" respectively. At the time of supply, it is unlikely that the supplier will have filed a GST return or made payment to Inland Revenue. This may not be "accounted for" at the time of importation of the goods. This arises because of the different term used in the amendment to section 12(1) ("charged") which suggests that 12(1B) may be interpreted differently.

We submit that "accounting" and "accounted" in proposed sections 12(1B)(a) and (c) are replaced with the words "charging" and "charged" respectively.

We note that page 28 of the commentary on the bill uses the words "identify the items in the consignment on which tax has been **charged**, the rate at which tax was **charged** on these items, and the registered person who **charged** GST on the distantly taxable goods". Our submission is consistent with the commentary and the policy intent.

Receipts for supply of low-value imported goods

KPMG submission

The new section 24BAB of the GST Act should include a provision allowing a registered person to agree with the Commissioner, an alternative set of information to be included in a receipt for the supply of low-value imported goods.

Comment

The new section 24BAB provides that a registered person who makes a supply of distantly taxable goods must (at the time of supply or 10 working days after a request from the recipient of the supply) provide a receipt to the recipient containing the following information:

- the name and registration number of the supplier:
- the date of the supply:
- the date upon which the receipt is issued:
- a description of the goods supplied and the other goods imported:
- the consideration for the goods, and the amount of tax included, which may be expressed in the currency of the consideration received by the supplier:
- information indicating the items for which the amount of tax charged is more than zero and the rate charged for each of those items:
- information indicating the items for which the amount of tax charged is zero.

We understand that the purposes of requiring a registered person to provide a receipt is to give the recipient a document evidencing that GST has been charged on the goods supplied to them This can then be used to ensure that the goods are not taxed twice (i.e. on the point of sale and again at the border when the goods are imported). If so, there may be other information that can be provided by the registered person apart from the information prescribed in section 24BAB, or other ways that a registered person can show that GST has been charged on the supply of the goods.

Accordingly, there should be provision that allows the Commissioner discretion to agree on an alternative set of information to be included in a receipt required to be issued by a registered person under section 24BAB. This provision would be similar to the current section 24(6) of the GST Act that allows the Commissioner to alter the requirements of a tax invoice where certain requirements are met.

Marketplace operator or redeliverer's reliance on information provided by underlying supplier

KPMG submission

The new section 60G(1) of the GST Act (per clause 37 of the Bill) should not be an exhaustive list, but rather should be an inclusive list of situations where a marketplace operator or a redeliverer will not be liable for GST on supplies of low-value imported goods, where it has relied on incorrect or misleading information provided by an underlying supplier.

Comment

The new section 60F of the GST Act provides protection to a market place operator or a redeliverer where the incorrect amount of GST has been returned due to its reliance on inaccurate, incomplete, insufficient, or misleading information provided by the underlying supplier. Section 60F will only apply where the requirements of section 60G are met.

Section 60G(1) as it is currently drafted, is an exhaustive list of situations where protection under section 60F will be available to a marketplace operator or a redeliverer. We note while the list covers a broad range of situations, it may not cover all possible scenarios where inaccurate, incomplete, insufficient, misleading information provided by the underlying supplier results in the incorrect amount of GST being returned (for example, it does not cover a situation where the underlying supplier has incorrectly classified the good which results in the incorrect GST rate being applied).

Identifying the residency of the underlying supplier and location of the goods

KPMG submission

That the requirement for a marketplace operator to obtain a declaration from the underlying supplier that they are resident in New Zealand under section 60G(2)(a)(iii) be removed, and that section 60G(5) also include the location from where the goods are being shipped from as one of the items of information that a marketplace operator can rely on in determining the residency of the underlying supplier.

Comment

The requirement to obtain a declaration from the underlying supplier is onerous given that this is very unlikely to be something that marketplace operators have asked from the underlying suppliers when they initially signed-up with the marketplace operator. While arguably, it is possible for marketplace operators to get this information for new suppliers (which would entail some costs as their on-boarding systems will need to be updated for this), marketplace operators will still need to contact all their currently signed-up suppliers globally to obtain this declaration, if the marketplace operator wanted to rely on section 60G(2)(a)(iii).

In respect of section 60G(5), we consider that the location from which the goods are being shipped from is a good indication of the residency of the underlying supplier. Section 60G(2)(a)(iii) requires 2 items from the list in section 60G(5) to be relied on and as such, the location from which the goods are being shipped from will also need to be consistent with another item of information listed in this section.

We appreciate that section 60G(6) does allow for the Commissioners to prescribe and/or agree with a marketplace operator an alternative list of information to be relied on under subsections (2) to (5) of section 60G. However, our suggested changes above will broaden the scope of the information that a marketplace operator can rely on when determining the residency of the underlying supplier without having to rely on Commissioner discretion. This will provide certainty to marketplace operators as they prepare to implement the proposed new rules on

low-value imported goods, and will also reduce their compliance costs (i.e. as they do not have to engage with the Commissioner to agree on the alternative requirements).

Implementation costs

KPMG submission

To the extent possible, the provisions relating to GST on low-value imported goods should allow for some flexibility that would enable affected businesses to comply with the new rules in the most cost-efficient manner.

Comment

We appreciate that this submission is vague, but Parliament would be remiss to ignore the fact that the proposed GST on low-value imported goods will impose significant costs to some affected business in order to comply with the new rules. These would include one-off costs (e.g. getting their reporting/billing systems updated to allow for the GST to be charged correctly on affected transactions), and on-going compliance and operational costs (e.g. for marketplace operators, having to incur payment processing fees in order to separately collect GST imposed on a sale from the underlying suppliers).

Many affected business will no doubt carefully consider how they can comply with the new rules in the most cost-efficient way, and the proposed rules should, to the extent possible allow for flexibility to cater for solutions that affected businesses may present. We have touched on some of these scenarios above (e.g. giving the Commissioner discretion to agree on alternative informational requirements in some cases), but there may be other situations that will not be identified until a later stage (e.g. when practical difficulties are identified are encountered by affected businesses and they try to formulate solutions to address these problems).

We further note that with today's technology it is much easier for the Commissioner to track and verify GST. Detailed rules which assume a particular model or flow of information and payments are less necessary than when GST was originally introduced in 1985.

Reimbursement by supplier if recipient double taxed

KPMG submission

Inland Revenue or Customs and not the supplier should provide a refund to a consumer where GST has been collected by both the supplier and Customs.

Comment

If goods have had GST charged on them by both Customs and the supplier, proposed section 12B allows the recipient to request a refund from the supplier. The supplier must then provide a refund to the recipient, provided the supplier receives confirmation that GST was paid on importation. It would be much easier for the customer to claim a refund from Inland Revenue or Customs rather than the supplier, and prevent extra administrative burdens being imposed on suppliers.

If this submission is not accepted, Customs should be required to provide information to the supplier that GST has been charged on importation to confirm to the supplier that GST has been paid on importation.

Impact of the new rules at the border

KPMG Submission

The effect of the low value goods threshold should be clearly stated and the effect and intention of section 12(4)(c) reviewed.

Comment

The low value goods threshold is not explicitly provided for in the GST Act. The apparent flow is that:

- section 12(1) to (2) imposes GST liability on goods imported into New Zealand;
- by virtue of 12(3) and (4), this GST is collected by NZCS in accordance with Customs and Excise Act;
- section 12(4)(c) provides authorisation for the low value goods threshold to be applied by NZCS.

It is the later therefore which allows goods to be imported without GST. The system, to date, has operated as far as we can tell relatively efficiently. However, the introduction of the supplier model requires clarity and certainty to ensure that there is not double taxation and that not non taxation.

In this regard, the concerns are low value goods imported by:

- a New Zealand consumer but not supplied by a registered person;
- a New Zealand business where the supplier is registered (so that double taxation does not apply) or not registered (so that GST is not collected simply to be claimed as input tax).

We understand that the Bill achieves the purpose relatively clearly for consumers. However, for businesses, this is less clear as the section 12(4)(c) proviso appears to limit the ability of businesses to benefit from the low value goods threshold.

We have not been able to confirm how section 12(4)(c) should operate but this should be confirmed and any necessary amendments made.

GST incurred in making financial services for raising funds

KPMG submission

Revised section 20H(1) should be amended to relax the requirement that a deduction is only available for a registered person who **principally** makes taxable supplies.

Comment

We note the requirement in the original and amended section 20H(1), that the section applies to "a registered person who **principally** makes taxable supplies". This means that GST on capital raising costs can only be claimed where the value of taxable supplies exceeds the value of exempt supplies including capital raising supplies, in order to satisfy the "principally" test. This has the following adverse consequences:

- businesses (for example in the technology sector) who intend to but are not currently making taxable supplies may not be able to claim GST on capital raising costs. This could include start-ups and others who, often due the nature of the business, raise capital in advance of making taxable supplies for example in the forestry industry, and property developers;
- established businesses making taxable supplies, but which raise capital in excess of the value of those taxable supplies would not meet the "principally" test.

This problem is also in part due to uncertainty on how the test should be applied. If the test is applied at the time, it is unlikely to be met. If it can be measured based on the purpose of the expenditure (i.e. looking forward to the expected result of the capital raising) it may be met.

This outcome appears to be an unintended consequence of the change to the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill between its introduction and enactment. When introduced, it was proposed that a new section 11A(1)(rb) would allow deductions for capital raising costs by zero-rating certain exempt supplies. This was amended prior to enactment to allow a deduction for costs provided the conditions of section 20H are met. The original intent was set out in the commentary on the bill as follows:

> *"The proposed amendment will allow businesses to recover GST incurred on goods and services used to raise capital, to the extent that the capital funds their taxable activity."*

We therefore recommend that this section is changed so that in establishing whether the registered person is "principally" making taxable supplies, the exempt supplies arising from capital raising are excluded, and the test is broadened to include registered persons who intend to principally make taxable supplies.

Ring Fencing

The decision on whether to implement the rules should be deferred

KPMG submission

The loss ring-fencing rule is being introduced as the capital gain is not being taxed. As the Tax Working Group has recommended that a capital gains tax is introduced we recommend that the decision on whether the loss ring-fencing rules should be introduced should be deferred to after the Government has confirmed whether they intend to introduce a capital gains tax.

Comment

The officials' issues paper on ring-fencing rental losses, published in March 2018, ("the officials' paper") stated that the Government *"has committed to a number of policy measures aimed at making the tax system fairer and improving housing affordability"*. In relation to how the ring-fencing rental losses policy would support this commitment it stated:

> *While interest and other expenses are fully deductible, in the absence of a comprehensive capital gains tax, not all of the economic income generated from rental housing is subject to tax. There is therefore an argument that, to the extent deductible expenses in the long-term exceed income from rents, those expenses in fact relate to the capital gain, so should not be deductible unless the capital gain is taxed.*
>
> *The introduction of loss ring-fencing rules is aimed at levelling the playing field between property speculators/investors and home buyers. Currently investors (particularly highly-geared investors) have part of the cost of servicing their mortgages subsidised by the reduced tax on their other income sources, helping them to outbid owner-occupiers for properties. Rules that ring-fence residential property losses, so they cannot be used to reduce tax on other income, is intended to help reduce this advantage and perceived unfairness.*

The officials' paper concluded that rental losses "*should not be deductible unless the capital gain is taxed"*. The Tax Working Group has recommended that a capital gains tax is introduced. If a capital gains tax is introduced the reason for ring-fencing losses would no longer exist and the new rules should not be introduced. Therefore, the decision on whether the loss ring-fencing rules should be introduced should be deferred to after the Government has confirmed whether it intends to introduce a capital gains tax.

Further, the officials paper states that the loss ring-fencing rules are *"aimed at levelling the playing field between property speculators/investors and home buyers"* and the new rules are *"intended to help reduce this advantage and perceived unfairness"*. (We note that we considered that a property speculator does not have this perceived advantage. A property speculator, being someone who buys to sell, is taxable on any gains. The problem does not arise).If the loss ring-fencing rules were introduced, and a capital gains tax is introduced, the combined impact of these two changes would not result in a level playing field between property speculators/investors and home buyers. If these two changes were introduced it is likely that speculators/investors would pay capital gains tax and home owners would not pay capital gains tax so this would result in a significant advantage to home owners and would be unfair. This again suggests that the loss ring-fencing rules should not be introduced if a capital gains tax is introduced, and the decision on whether to introduce them should be deferred.

Finally, the final report by the Tax Working Group stated that: *"To the extent the taxation of capital gains could put upward pressure on rents, the removal of ring-fencing on residential rental property may aid in limiting potential rent increases".* Therefore, the Tax Working Group considers that the loss ring-fencing rules could contribute to upward pressure on rents, and this supports deferring the decision on whether the loss ring-fencing rules should be introduced.

Potentially, the new rules could be introduced and then repealed in the future if a capital gains tax is introduced. If a capital gains tax is introduced it is likely to apply from the 2022 tax year. Therefore, if the new loss ring-fencing rules were introduced, and then repealed when the capital gains tax applied, the loss ring-fencing rules would only be in place for the 2020 tax year.

We consider that introducing rules that may potentially only be in place for two years would have a negative impact on a large number of taxpayers and they would incur unnecessary costs and uncertainty. Accordingly, we recommend that the decision on whether the new rules are introduced are delayed until the Government decide whether to introduce a capital gains tax and the new rules are not introduced if the Government look to introduce a capital gains tax.

Alternative approach

KPMG submission

The loss ring-fencing rule be modified so that it only applies to interest expenditure.

Comment

We understand the policy concern is mainly related to where taxpayer's "artificially" inflate losses through negative gearing of properties (i.e. maximising the tax benefit of interest costs). The new rules would result in a rental loss, regardless of the underlying cause, being ring-fenced. This will include situations where a loss is due to "hard costs", such as significant repairs and maintenance, during a year.

If the main policy concern is in relation to highly leveraged properties, a more targeted approach is an ordering rule which limits interest deductions to gross rental income. Under this approach expenses other than interest could still be deducted, and to the extent that results in a loss, that loss would still be allowed. However, any excess interest deductions would be ring-fenced and carried forward for future offset.

This would not be our first preference, as we consider that rental properties should be taxed in the same manner as other investments, but this approach would at least better target (what we understand to be) the concern as compared to a general rental loss ring-fencing rule.

The "main home" exclusion be expanded

KPMG submission

New section DB 18AE is revised so that the main home exclusion is expanded to include persons who are temporarily overseas and rent out their home.

Comment

A taxpayer's "main home" will not be the subject of the rental loss ring-fencing rule. We consider, under the proposed rules, some properties may not get the benefit of the main home exclusion where there is a policy justification for allowing the exclusion to apply.

For example, where a taxpayer has rented out their New Zealand property while working overseas. In that situation, their main home, per the proposed legislation, would arguably be in the country they are working in (e.g. if their family, employment and person property is in that other country). This would mean any New Zealand rental losses will be ring-fenced. This is notwithstanding the property would be their main home if they were living in New Zealand (and,

for tax residence purposes, it could still be considered as giving rise to a permanent place of abode by Inland Revenue).

To address this concern, under new section DB 18AE the main home exclusion should be available for a person's residential New Zealand property (if that was, or could reasonably be, their main home if living here) where they continue to retain their New Zealand tax residence.

Non-New Zealand residential properties should be excluded

KPMG submission

An exclusion is introduced so the loss ring-fencing rules do not apply to non-New Zealand rental properties.

Comment

The officials' paper states that the purpose of the loss ring-fencing rules is to level the "*playing field between property speculators/investors and home buyers"* and the current rules helped investors *"outbid owner-occupiers for properties"*. Therefore, applying the loss ring-fencing rules to residential properties outside of New Zealand is not in line with the reason for introducing the new rules. Accordingly, non-New Zealand residential properties should be excluded from the scope of the proposal.

This is particularly an issue as the issue highlighted above for the main home exemption will also apply where someone is seconded to work in New Zealand and they rent out their overseas family home while living here. If they become New Zealand tax resident, they will be taxable on their net foreign rental income. Assuming their mortgage is denominated in a foreign currency, New Zealand's financial arrangement rules can give rise to significant unrealised income/(losses) for tax, due to currency fluctuations. Therefore, the New Zealand tax result may have little relation to the actual rental position – the loss could relate solely or largely to unrealised foreign currency movements on the mortgage.

If a general exclusion for non-New Zealand residential properties is not supported then we consider that:

— An exclusion should be available for the non-New Zealand residence of a "transitional resident" (if that would or could be their main home if living overseas). This would be in line with the policy rationale for the transitional residency rules, being to encourage non-residents to migrate to New Zealand.

— Any foreign exchange losses should be excluded from the loss-ring fencing rules. That is, any foreign exchange loss should be able to be offset against the taxpayer's other income.

Interposed entities

KPMG submission

The interposed entity rules are modified so that an interposed entity can offset ring-fenced losses if they derive income that is related to residential rental property income.

Comment

The new rules will ring-fence losses, in certain circumstances, for interposed entities. The ring fenced losses will be able to be carried forward but as the interposed entity is unlikely to receive *"residential rental property income"*, as that term will be defined, it is unlikely that the interposed entity will have any income to offset the ring-fenced losses.

For instance, in the example in commentary on the Bill, it is the interest of the shareholder Alex, that will be ring-fenced but the Company own the residential property. Therefore, it is unlikely that Alex will receive residential rental property income. However, Alex may receive dividends

from the company and the funds from the dividends may be from residential rental property income that the company derived. We consider, in this situation, the ring-fenced losses of Alex should be able to be offset against the portion of the dividends that relates to residential rental property income.

More broadly, the interposed entity rules should be modified so that an interposed entity can offset ring-fenced losses if they derive income that is related to residential rental property income.

Timing of introduction

KPMG submission

If the loss ring-fencing rules are introduced we recommend that they should be phased in over 5 years in accordance with the original election policy.

Comment

The new loss ring-fencing rules are proposed to be introduced in full in the 2020 income tax year. However, the Government's 2017 election policy suggested that any changes would be phased in over a five year period (with 20% of the loss ring-fenced in the first year; 40% in the second; and so on).

The rules will potentially impact a large number of taxpayers and their existing arrangements, including where different investments, not just rental properties, are held through entities.

There is unlikely to be sufficient time, between the introduction of draft legislation and its enactment, given the proposed 1 April 2019 application date, for taxpayers to fully assess the impact of the change on their circumstances and to make adjustments, if required.

Accordingly, if the rental loss ring-fencing proposal proceeds, we recommend that the Government's election policy is followed and the new rules are phased in. This would allow affected investors time to adjust to the new rules, or to rearrange their affairs before the rules apply in full. The phasing of the new rules should be over 5 years per the original election policy. This will also allow time for the inevitable corrections to be made while those errors would have a lower impact.