

TAX IMPLICATIONS OF FARM DWELLINGS *(by Chris McDonald, Tax Manager, McIntyre Dick & Partners Limited)*

The place of farm dwellings in assessing income and tax can be complicated.

The implications differ depending on the occupier: whether that person is an employee, a shareholder, a settlor or beneficiary, or a lessee.

The person providing the dwelling need not be the owner of the dwelling for tax implications to arise. For example, where a sharemilker is supplied with a dwelling and then supplies the dwelling to his/her employees the dwelling is treated as being supplied by the sharemilker. Tax implications therefore arise between the sharemilker and his/her employees.

Employee

Where a farm dwelling is occupied by an employee, and a rental lower than market rate is being paid, this results in additional taxable income to that employee.

Let's take an example: an employee is paid \$400 a week, and is given a free house with a rental value of \$80 a week. For tax purposes, the employee's taxable income is \$480 a week.

The employee receiving the benefit of living in the dwelling is required to include the additional rental value of the house in his or her taxable income for that income year; the employer must deduct PAYE for that employee on the assumption that taxable income is \$480 a week, not \$400.

Shareholder

If the occupier is a shareholder, ie the dwelling is provided by his or her company, two situations can apply:

- the shareholder is an employee, in which case, if he or she pays no rent, the rules relating to employees (above) apply. The market value of the rental is taxable income to the shareholder.
- the shareholder is not an employee, in which case the benefit of living in the house rent-free is a dividend to the shareholder valued at the market rental that would otherwise be payable.

To avoid this situation, where shareholder employees or shareholders reside in farm dwellings provided by their companies they must pay rental to the company.

Relatives of shareholders living in dwellings on farms without paying adequate rental incur FBT, or receive dividends, so rental must be paid in family situations for non-employees and non-shareholders as well.

Trusts

The tax implications are even more complicated where a trust owns the dwelling. Where there is an employment relationship between the trust and the person living in the dwelling the rules relating to employees (above) apply. Where there is no employment relationship no tax implications arise. However it must be remembered that where there is no rental actually paid or deemed to be paid the trust would be unable to claim a deduction for tax purposes for expenditure incurred in regard to the dwelling (depreciation, maintenance etc.). The trust is not earning income from this expenditure.

Level of Rental

The level of rental required to satisfy the Inland Revenue Department is currently a matter of some debate. Previously rental was assessed using a formula based on the value of the house. In many cases, the use of this formula gave an unrealistically high rental for farming properties, particularly those in remote places.

Rentals should be discussed with your tax advisers at the time of your annual review on the basis of the likely rental value of the property in relation to other similar properties being rented in the district.

If you pay a market rental based on what you would receive in rent for this property from a non-related party, this would be sufficient.

If you pay rental for the use of a dwelling on the company's/trust's farm property, the dwelling becomes part of the income earning assets of the company/trust. This allows the company/trust to claim for depreciation and for all expenses incurred in maintaining the property.

It does not, however, allow the company/trust to claim back GST on the costs associated with the dwelling, as residential property is specifically excluded from GST.

The situation outlined above applies mostly to farmers, but the rules are the same for any dwellings used by shareholders, employees or relatives. As with all tax matters, underpayment of tax can bring severe penalties.