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Portfolio Investment Entities (PIEs)

What is a PIE?

A PIE is a class of collective investment vehicle. The key benefits of a PIE are:

- Investments in most Australasian shares will be taxed on income only – not capital gains.
- Investors are taxed at their Prescribed Investor Rate (PIR) instead of a higher marginal tax rate.
- The top PIR is capped at 30%.
- Generally, New Zealand resident companies and charities will have no tax on income deducted by a PIE (a 0% PIR) and will need to account for any tax payable in their end of year tax returns and pay provisional tax as required.
- NZ resident Trusts can elect to have tax deducted at a PIR of 30% or 0%.
- NZ resident partnerships would generally have tax deducted at the highest PIR of all the partners.



More Tax Credits for Charitable Giving

Individuals

For individuals there is no longer a rebate cap (previously set at \$630). This means that individuals are able to claim a 33¹/₃% tax rebate on all charitable donations up to their taxable income. For example, if a person who has taxable income of \$80,000 makes charitable donations of \$20,000 during the year, the tax rebate available is \$6,667, reducing the effective cost to the donor to \$13,333.



Companies

The deduction is available to all companies, including unlisted close companies. Previously no deduction was available to close companies

unless their shares were listed on a recognised exchange. Companies are able to claim the deduction each year for gifts of money up to the amount of their net income.

Year End Processing

For most taxpayers the end of March represents the end of the financial year, so now is a good time to check that the books are in order. In some cases 31 March is the crucial date for getting things done. Some of these have been outlined below.



Bad Debts - in order to claim a deduction for bad debts they must be written off before the end of the financial year in order to get a deduction in that year. When assessing whether or not a debt can be written off, businesses will need to consider things like the age of the debt and the likelihood of the debt being collected. In the current economic climate, more emphasis should be given to debt collection. However, if debts do not look collectable, they should be written off to provide a more accurate reflection of the business's profitability.

Assets - equipment purchases should be reviewed to ensure that any assets costing more than \$500 are capitalised for tax purposes. This can often be overlooked especially where such assets are expensed for accounting purposes.

Subvention Payments - for group companies that recorded subvention payments in their 2009 income tax returns, time should be spent to confirm those payments are made by 31 March 2010, because in order for a subvention payment to be effective for tax purposes, the physical payment must be made by 31 March of the following year. In some cases the tax return is completed to include the effect of the subvention payment, however the actual payment is not made by the deadline. The effect of this non-payment is that the subvention is deemed not to have occurred.

Holiday Pay - entities wanting to get a deduction for accrued holiday pay or employee bonus payments must ensure that the holiday pay and bonus payments are "incurred" at balance date and paid within 63 days of balance date.

Herd Scheme Election - for farmers wanting to exit the Herd Scheme, the election must be done at least a year and a day before the income year in which the National Standard Cost scheme is adopted.

Income Equalisation Scheme – this is a useful tool for farmers wishing to adjust their taxable income. Where farm income for the year is high, and insufficient provisional tax has been paid, the farmer should consider making an Income Equalisation deposit to reduce the possibility of use of money interest being charged. Conversely, if there are tax losses for the year, an Income Equalisation refund may be sought to offset against the losses.

Imputation Credits and Dividends - if a company has imputation credits that have arisen based on the old company tax rate of 33 percent the question should be asked whether or not to declare a dividend to shareholders to utilise those credits. The cut off date for declaring dividends to utilise those imputation credits is 31 March 2010 irrespective of a company's balance date. From 1 April 2010 imputation credits are limited to the equivalent of 30 percent - in line with the current corporate tax rate. Before a dividend is declared, consideration should be given as to whether or not it will get taxed in the shareholders hands at the top personal marginal tax rate of 38 percent versus imputation rate of 33 percent and whether cash is available to meet that tax shortfall.

There are quite a number of issues that need consideration before the financial year end - the above are offered as reminders of some of them.

Renting from your LAQC

If a Loss Attributing Qualifying Company ('LAQC') incurs a taxable loss, that loss is deemed to be incurred by its shareholders in proportion to their shareholding. This unique blending of the

separate entity concept and the ability to attribute losses from a company has led to a practice of people living in houses rented from LAQC's in which they own the shares.

To start the process, a company is incorporated and an election completed for that company to be an LAQC. A house is purchased by the LAQC and rented to its shareholder(s) who live in the house. A taxable loss is incurred as the expenses associated with owning and renting the house, such as rates, insurance and interest, exceed the rental income. That loss is attributed to the shareholder(s) and offset against the shareholder(s) income typically resulting in a tax refund. For most tax and accounting professionals this is not an acceptable practice as the situation is essentially a way of claiming, for tax purposes, expenditure that would normally be of a private nature. However, the practice has persisted and is even encouraged, as some professionals take a different view.



Taxation Review Authority ('TRA') case Z20 recently settled whether the practice is acceptable. The case involved a taxpayer that had incorporated an LAQC with her as the sole shareholder, and her accountant as sole director. The LAQC, with funds borrowed from a related trust, purchased a house and rented it to the taxpayer (shareholder) to live in. Losses incurred by the LAQC over a four year period totalled \$70,801. The losses were attributed to the taxpayer and resulted in tax refunds totalling \$27,612.

The taxpayer argued she had merely exercised her right to structure her affairs within the law and followed advice not to own the house personally for protection against relationship property claims, and eventual retirement needs. As the expenses were incurred to derive rental income they were correctly deductible and the resulting loss was attributable to the shareholder as the company was an LAQC.

The IRD argued that, even though the various components of the arrangement came within the

black letter of the law, when viewed as a whole the arrangement was put in place to enable personal expenses to be claimed to reduce the tax liability and was therefore tax avoidance.

The Judge agreed that in isolation the components of the arrangement fell within the black letter of the law but when taken as a whole the arrangement was not of a kind that would have been contemplated by Parliament and the combined effect gave rise to a tax avoidance arrangement. The Judge was of the view that Parliament would not have contemplated that a taxpayer would be able to obtain deductions related to the shareholder's personal domestic accommodation and for the shareholder to gain a tax advantage from those deductions by utilising an LAQC in such a way. The fact that rental income was not derived from a third party added to the artificial and contrived nature of the arrangement.

The taxpayer also attempted to argue that any tax avoidance purpose or effect was merely incidental to the reasons for which the arrangement was entered into (as referred to above). On this point the Judge stated: *"While the disputant may put forward other non-tax purposes and effects in this case, the purpose and effect of tax avoidance is just too obvious to be merely incidental."*

Although the tax in dispute was considerable, the implication of this decision is the key issue as it confirms that such an arrangement is tax avoidance. There will be instances that will not be as clear cut, such as when a shareholder of a LAQC lives for a short period of time in a property owned by a LAQC, that was previously, and will in future be, rented to third parties. However, in this instance the IRD have correctly taken the matter to the TRA to provide certainty – the only question is why it wasn't settled years ago.

Expansion of Associated Persons Rules

Until the recent passing of legislation in late 2009, it had been reasonably easy to hold land in entities that are not associated with land dealers, land developers or builders, and in doing so, ensure that any future profit on the sale of that land is not likely to be taxable. The recent legislation passed by the Government greatly expands the "associated persons" rules. The intent of the new legislation is that property dealers, developers, builders, and their associates

are generally taxed on all gains on property sold within 10 years of acquisition.

Given the clear intent of the rules, a structure that appears to deliberately circumvent the new rules may be viewed by the IRD as a tax avoidance arrangement. However, gains from the sale of land may not necessarily be taxable even though a person is tainted by association. Generally, if a person holds land for more than ten years, any

profit on its sale should not be taxable. If a person is associated to a builder, the land will be taxable on sale only if it is sold within ten years of improvements being completed. If no improvements are made the land will not be subject to tax on sale if sold within 10 years. In order for an entity to taint a person, that entity must be in the business of developing or dealing in land when the land was acquired by the person. An entity in the business of erecting buildings will taint a person if the person commences building improvements on land while associated with the builder. Whether an activity amounts to a business is a question of fact based on case law.



Finally, there are exemptions to the land taxing provisions to provide relief in specific scenarios. If a property is used by a taxpayer principally as a place of residence then any gain on its sale

should not be taxable. In certain scenarios whether the exemption applies will be unclear, for example, where a property has been used as both a residence and to derive income (such as rental income). There is also an exemption for land used as business premises.

With the tightening of the associated persons rules, more land sales will be subject to tax. Application of the exemptions will need to be considered on a case by case basis.

Given that the land taxing provisions are now more wide ranging, disputes with the IRD about the application of the new rules and possible exemptions are more likely to occur. In view of this, careful consideration should be given when deciding how a land transaction should be treated.

Snippets

Sensible Sentencing Trust's Charitable Status at Risk

The concept of what qualifies as a charitable entity is one that has developed over hundreds of years as the needs and values of society have changed. That history has been encapsulated in the Charities Act 2005 which provides a definition of what a "charitable purpose" is, and it is this definition that the Charities Commission has been applying to the applications received since the Commission's commencement.

Broadly, an entity will qualify as being charitable if its purpose is the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community. The Act allows an entity to have an advocacy purpose but this cannot be its primary purpose.

The Charities Commission has indicated that the Sensible Sentencing Trust's application for charitable status may not be approved because the Trust's main purpose is political and not beneficial to the community. The Trust recognises that it is involved in political advocacy but maintains its primary purpose is to provide various forms of assistance to victims of violent crime.

IRD Changes its View on Business Relocation Costs

In 2005 the IRD issued a draft interpretation statement setting out its view on the deductibility of various types of costs incurred when relocating business premises. Recognising that relocating business premises can be an ordinary incidence

of running a business, most types of expenditure in the statement were concluded to be revenue in nature and deductible. However, the statement advised that costs associated with relocating fixed assets are capital in nature and non-deductible, but those costs may be depreciated.

Following public consultation the IRD has re-released the draft interpretation statement in late 2009. The updated statement concludes that where a business relocation occurs to maintain and preserve the business, and not to operate a new type of business or operate the business in a different way, all business relocation costs will be deductible. This would include the costs associated with relocating fixed assets.



However, the statement provides that where a business relocation is capital in nature (e.g. to expand into a new business venture or operate in a different way) the associated expenses will not be immediately deductible or depreciable, i.e. it will be a "black hole" expenditure.

If you have any questions about the newsletter items, please contact us, we are here to help