



# Tax Tonic February 2020

## Carl Brandt & Julie Segedin

### Rental Loss Ring-fencing

Q: It seems that the Portfolio method for multiple rentals would be the most flexible option to choose - particularly as most are or have been in the past held by LTC and or individual, P'ship owned

A: *Agreed, I think it is going to be quite a rare occasion that the property by property basis is elected. Possibly where the property is actually sold before the first set of accounts are completed.*

Q: A client has 2 companies with the same ownership. A owns Res Rental which makes a loss. B has Business income making a profit. Can a subvention payment be made to offset the losses

A: *Great question. Section EL 15 (refer below) allows ring-fenced deductions to be transferred between companies in a wholly-owned group (ie 100% identical shareholding percentages). The transfer is treated as made when both the transferor and the transferee take tax positions on that basis in their tax returns for the relevant income year. This process is akin to a loss offset ie it is only a tax entry in the returns there is no exchange of funds as there is with an exemption. This could lead to a potential mismatch between retained earnings and ICs that occurs with loss offsets.*

*In your example if Coy B only has business profits the deductions transferred are still ringfenced. Thinking it would only be worthwhile doing it, if for some reason Coy B was going to have residential rental profits and Coy A wasnt*

#### **EL 15(1) TRANSFERRING UNUSED AMOUNTS**

*If a company (company A) that is part of a wholly-owned group of companies has an unused excess amount carried forward under section EL 4(3), EL 5(3), or EL 7(3) for an income year, the company may transfer some or all of the excess amount to another company (company B) in the group.*

#### **EL 15(2) COMPANY B'S DEDUCTION**

*The amount transferred is treated as a deduction for expenditure or loss referred to in section EL 4(1) of company B in relation to a residential rental property of company B for an income year in which company B derives residential income.*

#### **EL 15(3) WHEN TRANSFERS MADE**

*The transfer of an excess amount is treated as made when both company A and company B take tax positions on that basis in their returns of income for the relevant income year.*

Q: When do you have to elect for property by property or portfolio?

*A: The default method is the portfolio method. The election to use the property by property basis is made by the taxpayer taking a tax position in their return that reflects deductions for the particular property only being used against income from that property. Interestingly, if all properties have profits or all have losses in all years neither option is locked in at that point as there has been no offsetting to default to portfolio. It would be important to keep each property separate in the accounts and then you could still chose the property by property option in the future if that property is sold and the sale is taxable (see next question for further details on this).*

*Important to note that if the property is definitely on revenue account (sale will be taxable) the rental deductions are not ring-fenced.*

Q: Hi Julie & Carl, in what instance would you elect to use the Property by Property (P by P) basis for residential properties?

*A: The only advantage of P by P is that any excess deductions could be released against other income if the sale of that property was taxable and an excess deduction still remains after that. If you haven't offset any loss making rentals against any profit making ones in the past ie portfolio hasn't been used (maybe they were all making losses) and when you go to file the next return a particular property has been sold for a taxable gain (eg bright-line) you could elect then to property by property that property by treating it that way and that would release any excess deductions at that point.*

Q: Where a rental loss is incurred by an Individual could you claim the accounting fee under Other Expenses (Return Preparation Fee) in the Tax Return instead of as part of the Profit/Loss under the Rental Income section.

*A: The following is the provision limiting the deductions:*

#### **EL 4 ALLOCATION OF DEDUCTIONS FOR LOSS-MAKING RESIDENTIAL RENTAL PROPERTIES**

##### **EL 4(1) WHEN THIS SECTION APPLIES**

*This section applies for an income year when a person is allowed a deduction for expenditure or loss incurred in relation to 1 or more properties in their residential portfolio, excluding any amount of a deduction under section DB 23 (Cost of revenue account property).*

##### **EL 4(2) LIMITED ALLOCATION**

*The amount of the deduction that may be allocated to the income year must be no more than the amount of the person's residential income for the income year.*

*The following is the provision allowing return preparation costs:*

##### **DB 3(1) DEDUCTION**

*A person is allowed a deduction for expenditure that they incur in connection with the following matters:*

*(a) calculating or determining their income tax liability for a tax year:....*

**.....DB 3(4) LINK WITH SUBPART DA**

*This section supplements the general permission and overrides the capital limitation, the private limitation, and the employment limitation. The other general limitations still apply.*

*The accounting fee is not incurred 'in relation to 1 or more properties' it is incurred in "calculating or determining their income tax liability". Accordingly, it is not ringfenced.*

Comment: Julie if loss is in personal name from LTC then shouldn't show in balance sheet of company (LTC).

*Response: Good point. In the LTC the deduction would just form part of the overall retained earnings or losses in the financial statements. No need to keep a record of it in there as it will be recorded in some way in the shareholders name.*

Comment: For recording the ring fenced deductions one suggestion is to use memorandum accounts.

*Response: A bit like an IC account which shows the rolling position for each year and then the total. If you haven't offset profits with losses at any stage, you may want to do this per property to make it possible to elect a property by property for a taxable sale that might occur in the future.*

## Donations and Roberts case

Q: Would it have been different if there was no loan back for the amount given to charity.

*A: Probably not in the Roberts case. I understand that it was not just cash included in the \$1.7m, there were a large amount of term investments and similar, which IRD would not accept as "money" or cash. Also, from a tax planning angle, her taxable income would not be high enough to get the tax credits if it were a single donation in one year. The loan back and gifting allowed the donations to be spread over several years.*

Q: Can the \$100k be considered a gift as a gift with no reason for it?

*A: Yes. The nature of a gift as per the courts, is that a gift will ordinarily be by way of benefaction, will usually not be made in pursuance of a contractual obligation and will ordinarily be without any advantage of a material character being received in return. The courts have said "a gift ordinarily proceeds from a detached and disinterested generosity, out of affection, respect, admiration, charity or like impulses."*

## Health & Safety benefits

Q: Health and safety - what amount massages to reduce office staff tension in necks and back.

A: Combined with answer below

Q: What about massages for employees inhouse? Where coy gets someone in monthly to give staff a shoulder massage.

A: Its useful to look at the purpose of the Health and Safety legislation as defined in the Act itself:

### **Purpose**

(1) *The main purpose of this Act is to provide for a balanced framework to secure the health and safety of workers and workplaces by—*

(a) *protecting workers and other persons against harm to their health, safety, and welfare by eliminating or minimising risks arising from work or from prescribed high-risk plant; and*

(b) *providing for fair and effective workplace representation, consultation, co-operation, and resolution of issues in relation to work health and safety; and*

(c) *encouraging unions and employer organisations to take a constructive role in promoting improvements in work health and safety practices, and assisting PCBUs and workers to achieve a healthier and safer working environment; and*

(d) *promoting the provision of advice, information, education, and training in relation to work health and safety; and*

(e) *securing compliance with this Act through effective and appropriate compliance and enforcement measures; and*

(f) *ensuring appropriate scrutiny and review of actions taken by persons performing functions or exercising powers under this Act; and*

(g) *providing a framework for continuous improvement and progressively higher standards of work health and safety.*

(2) *In furthering subsection (1)(a), regard must be had to the principle that workers and other persons should be given the highest level of protection against harm to their health, safety, and welfare from hazards and risks arising from work or from specified types of plant as is reasonably practicable.*

A: *There is no question that a massage could alleviate a health problem for an individual that they would not have but for the particular occupation they do ie if they didn't do that job they wouldn't have that problem. A good example is constant keyboard use that often causes RSI. However, it is also true that another person could do that exact same job and not have that particular health issue. This shows even though the health issue is linked to the occupation the issue also relates to the individuals personal physical condition. Accordingly the massage will benefit the person outside of the work environment and in my view means it would be classified as a private benefit.*

*However, if the massage is performed on the business premises it will be exempt from FBT under sec CX 23 in the same way that a gym on the premises would be. There are portable massage tables that are used on business premises for this exact reason and the convenience angle.*

Q: What if they are prescription safety glasses for the work place?

*A: Even though the prescription safety glasses are fixing a problem that is peculiar to the person there is no benefit because the person is not using those glasses anywhere but work. Presumably they have normal prescription glasses when not at work or get by without them! There is exact case law on this point that says specific eyewear required only for work is fine provided the person has already corrected the defect in their eyesight by another method outside of work.*

## Au Pair

Q: Au Pair- What if the couple rented an office space and added a creche where the Au Pair and child spent the day while the parents were working? Deductible?

*A: Yes that would meet the provisions of sec CX 23 and not be subject to FBT.*

Comment: Had a client found paying nanny through company wages by IRD and they had to pay back the deductions. By the way IRD found this by going through the register of nanny's association and cross-matching to PAYE records.

*Response: Hmmm interesting. That person is lucky IRD didn't click on to that being FBT calculated on the provision of a service at market value which would have cost a lot more!*

*Tip: If no FBT returns are actually filed there is no 4 year time limit for IRD reassessment. Perhaps consider filing Nil returns*

## ACC Earners Premium

Q: If a self-employed person has an ACC claim, the compensation is employee income. So does that mean the earner levy is not deductible?.

*A: Good question. In the year that the self-employed person incurs an Earners Premium, it meets the deductibility tests as it is a statutory cost to protect an income stream in "any income year", and is not a direct cost to actually derive employment income (as no one knows whether ACC will be called on). The nexus for deductibility is satisfied at the time the premium is paid as it relates more to the business. The nature of the ACC income when paid out is more than one step removed – it is still assessable income even though taxed with PAYE. It would be different if the ACC is paid as exempt income.*

**Comment:** Is Carl's example re reimbursing the shareholder for the CoverPlus Extra premium 'cheeky' so that the shareholder employee effectively has a deduction by only returning the net salary (in example \$66,245).

*Response from Julie: The way the CCH MTG paragraph was worded the whole premium was supposed to be debited to current account. That approach would mean no party got the benefit of a deduction for the work account premium and that's what the change in policy was designed to fix! A reimbursement of the earner premium depends on whether the expense would have been deductible if the employee prohibition didn't exist. Self-employed are allowed to claim the earner*

*premium. Conclusion the company can claim a tax free reimbursement of the total CoverPlus Extra premium. Interestingly I just noticed the MTG paragraph on this issue was changed in December 2019 to remove the reference to debiting the current account.*

*Tip: GST on the earner premium is only claimable by self-employed, not by partnerships, companies or shareholder employees.*

## GST and loss of earnings insurance

Q: The PIB says it applies to "accident policies". What about loss of earnings from other causes (eg health)?

*A: Other types of policies, such as health, medicare and similar are unlikely to be claimable for GST purposes as they are of a private nature and not in the course or furtherance of the taxable activity. An employer who provides health policies for staff would get a GST claim but there is then an adjustment required in the FBT return.*

Q: Question re GST on Insurance Payments - how about if the policy is company owned and is for "Business Disability Cover"- put in place to replace the insured person as the business can't continue without a qualified person (such as an accountant or insurance broker)

*A: This is commonly called "key person" insurance. The nature of these policies are primarily life policies and these are exempt from GST.*

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