



## Tax Tonic May 2022

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### Interest denial and MUA / rollover

Q: Edmund Commercial Property - is the Trust limited to the original cost?

A: IRD would consider yes – they have a policy statement on it. There is an argument that even though the parties are associated because there is a real change in ownership it can be uplifted to cost. If you or anyone else would like this covered in a bit more detail in a future webinar just email me – julie@jstax.co.nz

Q: Do ringfenced losses also get offset against bright-line sales? (Sorry a bit off topic)

A: Yes they do and if you are using the portfolio method it is the ringfenced losses for all the properties against the gain (can also be normal land sale profit)

Q: If someone has a section (bare land) to build their family home but it doesn't work out and they buy a ready-made house and sell the section, is this a taxable sale?

A: Yes – if its within the bright-line period – 5 years for a new build. If its outside the bright-line you would need to think about whether this is caught under sec CB 3 as a scheme or undertaking to make a profit. We have covered this in a previous webinar. Email me if you would like the webinar date. It is still available if you havent seen it and would like to purchase.

Q: Slide 8 - 25% interest denied applies from 1 Oct, assuming interest is spread evenly throughout the year, shouldn't the interest denied work out to be  $\$4,000 \times 6/12\text{mths} \times 25\% = \$500?$  - from Withers Tsang

A: Apologies – correct – modified an answer in an IRD example and failed to notice there facts were interest was only from Oct on – ie already reduced by 50%

Q: If a LTC purchase a residential property. first year rental, second year rental ceased for renovation and sold end of 2nd year. Is the loan interest in the 2nd year deductible against brightline profit?

A: Good question. Comes down to whether it is incurred in earning rental income for the whole period. If it wasn't rented again before sale it would be seen as non deductible so not released! Ugly and unfair. Note though that IRD have accepted interest between signing the sale contract and settlement caught by bright-line was deductible even for a bach because at that point the interest is incurred at the point income is going to be earned from the property. Not likely to be much.

Q: What if a pre-BL property transfer?

A: *Assume you mean the sale is not taxable but there is denied interest c/fwd? If so the denied interest is never claimable.*

Q: Can the land sale loss offset other residential properties sale income in the future?

A: *Assume you are referring to a bright-line loss that is ringfenced? Then yes it can regardless of whether it is in the same portfolio for loss ringfencing. As it is a bright-line cost and c/fwd interest will be part of the BL loss*

## Capital distribution to beneficiaries and interest

Q: if a loan is taken out to purchase shares in a close company and the company has now been wound up is the interest still deductible?

A: *Good question. The interest is no longer deductible from the date the company winds up. The reason the interest is deductible is because there is a nexus to dividend income, whether in the current year or in future years (as confirmed by the courts in the Brierley case). There will be no further dividends once the company is wound up. The nexus is broken and from that point the interest is non-deductible private expenditure.*

Q: The trust capital distribution - doesn't that create a deemed settlor problem?

A: *A capital distribution, by itself, does not create a settlor relationship. It is not a transfer of value into a trust (rather it is the reverse).*

*However where the capital distribution is credited to the beneficiary loan account, and the loan account balance is in credit of \$25,000 or more, there is now a deemed settlor relationship under section HC 27(6) unless the trust pays interest at the FBT prescribed rate.*

*Whether or not having a beneficiary as a deemed settlor is a problem is another matter, and can depend on whether there are land tainting issues or WFF tax credit entitlements etc.*

Q: Is the FBT interest to non-settlor beneficiary current accounts (if over \$25,000) deductible to the trust?

A: *Yes, it would be deductible where the trust has solely income earning assets. In this case the interest has a nexus to the trust's income. It is interest paid on 'working capital' left in the trust.*

*If the trust has a mix of income earning and private assets, the interest would have to be apportioned.*

*There would also be RWT issues if the interest exceeds \$5,000.*

Q: Slide 37 - should that bottom line be 10/40 not ten over 30. Private assets are one fourth of the total assets.

A: *Correct, sorry my mistake. The Trust had private assets of \$10m plus commercial property of \$30m, therefore total assets of \$40m. The apportionment is thus 10/40.*

## Trust disclosure

Q: I think it is an IR 833, not an IR 866?

A: *Correct (I must have been confusing it with the number of the Beast!)*

Q: Trust disclosure: if beneficiaries have loan account (liability) and current account (credit balance) do you combine 2 account balances when recording disclosure under current account box.

A: *Whichever is easiest!*

Q: If a Trust only has a TD and interest income (small amount of interest income), is it still required the full disclosure?

A: *If the interest is under \$200 and there is no other income it is not required to file a tax return and no disclosure when a tax return not required.*

Q: The new IR6s settlement disclosure (per IR6 guide 2022) requires you to disclose anyone who transfers value to a trust as a settlor then it says a settlement includes disposal of any property to the trust for less market value. Just want to double check if a person transfers a property to his trust at market value (no gifting), does this consider as a settlement? How about the next year, he did a forgiveness of debts for the loan trust owes him for purchasing the property. Will gifting then consider as a settlement?

A: *The sale itself wont be a settlement but the interest free loan of over \$25,000 will be – disclosure but can be nil value. The gifting of a loan is also a settlement – value is the face value of the loan.*

Q: On the new trust disclosures what about a trust created by a will e.g. leaving a lump of money invested only in term deposits with capital distributions made to descendants of certain people family members born or unborn at this stage and only in certain circumstances for their educational purposes. Settlor obviously dead. But seems they don't require the settlor info if no settlements in current year? Do we need find out beneficiary IRD#s to report the capital distributions.

Is there an exclusion for testamentary trusts?

When they ask if the trust is still active on the IRD website disclosure tool does this mean still going or only has passive investments (term deposits) not active (grasping – I know but....?) Can we say doesn't apply as a charity (although not a registered one).

A: *If the testamentary trust has any income other than interest under \$200 it has to file a return and will have to make a disclosure when filing. Even if there are no settlements in the current year they do want settlor details if that hasn't already been advised in the past. Yes, technically the distributions are reportable... Charity exclusion wont apply.*

## Australian LPs and foreign tax credits

Q: Can the flow through be to an individual? So Frank as partner? Or does it have to be a trust?

A: *The limited partner can either be an individual (Frank) or a trust. A trust is usually preferred as it is more flexible for tax purposes (ie. allocation of income to beneficiaries). Also a trust is preferred now that there is a 39% tax rate for individuals.*

Q: Page 53, do you mean an AU LTC owned by NZ trust?

A: *No. The LTC cannot be set up in Australia as the LTC regime is solely a NZ taxation regime and has no relevance in Australia. This is why Australia will tax it as a normal company, ie. at the 27.5% company rate, while in NZ we treat it as a flow-through entity including the Australian tax.*

*The LTC must be incorporated in NZ as a NZ resident company. It must also have NZ directors and the place of control and management in NZ. LTC status would be revoked if it were deemed to be resident in Australia under the DTA due to control/management there.*

## Correct Coding

Q: Company owned by 1% individual and 99% Trust. Individual main drawing the cash directly to his personal account. Companies dividends were credited to their current account according to their the shareholding. This has resulted that the individual's current account is overdrawn and the trust's current account is in credit. What evidences or documents do we need to do the journal to transfer the credit from trust current account to individual current account?

A: *You will need a deed of assignment of debt of the individuals current account. Company the assignor and Trust the assignee with the consideration being a reduction in the Trusts current account. Problem is that there will be interest payable until the assignment is actioned.*

## Close company vehicle elections

Q: For a closed company with a few directors/shareholders, what would be the best option for the motor vehicle claim? The company does not currently own any vehicles. They are too busy to record logbooks.

A: *I think its time we revisited options for vehicles and coys in general. Will note for either July webinar or the next one.*

Q: Close company vehicle option election, did IRD refuse the tax payer's log book option for claiming vehicle expenses as no written election was sent to IRD? What details do you need to put in when you send the vehicle option election message to IRD? Only a simple message to say the client elects to use logbook option to claim vehicle expenses or you need to put all individual vehicle details including the plate number and business use %?

A: *I never actually got feedback on that. You need to put the details of the vehicle ie regn number ie number plate. The percentage isnt required. I have just been asked about previous vehicles – I would think carefully about contacting IRD on those given the date for election has passed but definitely get it right going forward.*

## Resurgence Payments

Q: Resurgence payments – can client leave the unused resurgence payment received in bank account and use for future expenses (payment received more than expenses incurred)? And as at 31 Mar treated unused Resurgence Payments in a current liability code eg payment in advances?

*A: That is my understanding ie there is no timeframe referred to. The critical point is that the amount remains in the bank account until it is spent on business expenses. If it is never fully spent on business expenses it would have to be paid back*

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