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Trust information & disclosure

Exposure Draft:

https://taxpolicy.ird.govt.nz/publications/2021/2021-ip-reporting-requirements-domestic-trusts

Q: Julie, which beneficiaries must we disclose. All or just those that have had a distribution of any sort?

A: See next answer

Q: On the trust disclosures - do you know which beneficiaries info will need to be disclosed i.e. just ones with revenue distributions? What about capital distributions? Unnamed beneficiaries e.g. "children and children of children". For context a testamentary trust has unnamed beneficiaries who are descendants of certain family members who are under 30 and who are studying certain areas can get distributions to pay for study. Trust always pays tax on income and makes capital distributions to pay fees.

A: Based on the exposure draft it would be only those who have received some form of distribution whether that be an actual distribution (revenue or capital) or some form on non cash distribution eg stay for free in the family bach. For settlors there is a de minimis so you don't have to include minor/incidental settlements but there is currently nothing like that for beneficiaries. Hopefully that will change. Technically at the moment it seems if there was a beach house in a trust that a beneficiary stayed in for free but had not had any other distribution they would have to be disclosed.

Q: Do you think they may be looking to apply something like FBT to a trust?

A: The main reason for FBT on company loans is because the company gets a 100% interest deduction so the FBT cancels out a deduction on private borrowing. A trust doesn't get an automatic interest deduction. To be honest I don't think they know why they are looking at requesting all the info they are but once they have it they might find some use for it other than just looking at who is "avoiding" the 39%. I am thinking more around beneficiaries and deemed settlors for WfF and student allowances etc. There may also be some info shared with foreign tax authorities where overseas beneficiaries have been allocated income or had capital distributions that the overseas country might want to tax. Loans made to or from overseas parties might also be something they want to disclose.

LTC and exit dividends

Unrealised capital reserve and exit dividends

We refer to our example on Slide 34 where Jettz includes a $700k unrealised gain in its "exit dividend". After reviewing the legislation and the limited commentary available, we suspect that the s CX 63(4) is the result of sloppy drafting. There are probably alternative interpretations, one as per the webinar example, the other being that the exit dividend should exclude amounts which are excluded from "dividends" when a company winds up.

Perhaps it is not Parliament's intention that the $700k unrealised amount can be included in the exit dividend, however if so, the legislation does not hit the target and a strict interpretation would seem to allow it.

We recommend that care is taken when applying the exit dividend formula and advice is sought.

Q: The most cost-effective approach for this LTC Ordinary transition would definitely be just to simply clear the lot out on transition, I am sure?

A: As a general rule most people would clear out the reserves before the final 31 March of LTC status, and usually would clear them out as they arise. However as the webinar shows, the excluded dividend tax treatment still applies to the LTC reserves once it has become an ordinary company.

Q: For the example of exiting LTC status scenario, of Jettz Ltd revoking the LTC status on 31/3/21, would this be a voluntary revocation and that is why it becomes effective in the 1/4/21 year?

A: Yes, the example was based on a voluntary election which the shareholders sent to IRD by 31 March 2021. The revocation takes effect on the 1st April following the year the revocation notice is received, therefore Jettz Ltd becomes an ordinary close company from 1 April 2021. The deemed disposal of assets at MV happens on 31 March 2021, the final day of LTC status.

Q: Presumably, if the LTC had owned residential rental property, then the interest deduction would be zero though, no matter what the circumstances were?
Q: If a LTC holds a rental property, can we do the notional valuation, revoke the LTC to ordinary company and get interest deduction?

A: LTC revocations for companies which own residential property creates undesirable tax issues, including the restart of a new 10-year bright-line period. It is not 100% clear that interest deductibility is lost entirely, and I would argue that the phase out rules still apply. The bank debt hasn't actually been refinanced, it is still the same bank loan.

Q: For the example of LTC revocation, would the result be different if LTC was on-sold to an ordinary company with the same shareholding?

A: Good question. That could be an alternative option. It would trigger exactly the same tax issues for the LTC (depreciation recovered etc), and the capital gain would now be a normal realised capital gain. The new company could borrow from the bank to buy the properties, so the interest deductibility strategy works.
Perhaps the only downsides are the extra legal costs in transferring ownership and title, also whether there are commercial reasons for selling to a new company with the same ownership. You would need to think about the commercial reason (ie. can't be for limited liability as you

already have this) for doing this and given that exiting the LTC gives the same result without the need for any commercial justification it is the better option.

Q: Could you please go over the restart of the Brightline when exiting from an LTC again?

A: The revocation from LTC status triggers a deemed disposal and reacquisition of the assets at market value. Remembering that an LTC is not a "company" for tax purposes, it is the same as if an individual or partnership sold their property into an ordinary company. It restarts the 10-year bright-line period. There is no rollover relief for LTC revocations being considered in the current Tax Bill. The only rollover relief is when the LTC property is transferred to the LTC shareholders in the same proportion as their shareholding.

Q: Can LTCs have non-resident shareholders or would you not recommend that?

A: Yes, an LTC can have non-resident shareholders. The key issue is that it remains solely NZ tax resident, even with non-resident shareholders, ie. there needs to be NZ resident directors and the place of effective management and control must be in NZ.

Bright-line and co-ownership changes

This is the link to the offending document – its quite long!

https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/consultations/expired-consultations/pub00411.pdf?modified=20211109200805&modified=20211109200805

Q: Do the parents still need to pay capital gain if it is Jacks main home?

A: See next answer

Q: If Jack was living in the property does Ozzie still get taxed on his half when handing the full ownership to Jack?

A: Unfortunately yes as Ozzie is not living in it as his main home. It doesn't even matter if Ozzie doesn't even own another home – he has to actually live there to qualify. This situation is very common and a real problem. I will cover what might be a solution to this (if you are involved at purchase) in the next webinar when we go over the new rollover for bright-line

If Jack was letting out rooms in addition to living there does that make a difference to a main home exemption? What if Jack was living with his partner or letting out rooms?

A: Not sure if you saw Dec 2021 webinar but having flatmates or relatives/spouses living with you wont effect the main home exemption for Jack. Ozzie will have to account for his share of the rent from the flatmates in his return and Jack the other half.

If they'd used a trust to purchase (again not a rental) then sold to Jack would the trust get a main home exemption assuming Jack is a beneficiary?

A: The problem is usually that the parents end up being the principal settlor of the Trust and have a main home elsewhere. Will recap this issue in the next webinar.

Q: In the case of the 50% transferred to Jack. What is the case if the 50% is not transferred to Jack but to a completely different entity such as a Trust.

A: That wouldn't make any difference for Jack. He wouldn't have a bright-line profit on his half but the IRD would say its still a restart of the clock on the whole property. (I cant believe they wont change this but if you do have anyone considering this right now get them to wait until we know one way or the other).

Q: The mum purchased a home a couple years ago and has recently decided to subdivide the back section and gift it to her daughter. Would this trigger brightline for the mum?

A: If Mum qualifies for the main home exemption that does extend to land subdivided off. IRD have issued a QWB on this – see link below. If mum owns in a trust you need to make sure the subdivision is not more that "minor" otherwise sec CB 12 will apply.

2021 dividends and avoidance

Q: Where there are 2 directors in a company, if you pay a salary only to a working director who has a lower tax rate, will this be seen as tax avoidance?

A: It will come down to who is actually doing the work. If it is only the one you are paying no problem. In fact if an associate of the company isnt doing any work you cant legitimately pay them a salary anyway.

Q: What does the normal commercial terms mean?

A: That is the 64K question! I suspect they are referring to the dividend practice of large companies that arent controlled by a family. I assume they are saying a company that didn't have cash reserves would not declare a dividend but I would argue if the Companies Act says you can declare a dividend because the company is solvent it shouldn't be non commercial to do so otherwise the I would have thought the companies legislation would say something like that.

Trees and timber

Q: If you have fruit trees that could be used for timber (eg Pecan Nut trees can also provide valuable hickory wood) does a clause in the sale agreement stating they are fruit trees only work to stop the purchaser valuing after the fact and making problems for vendor.

A: Interesting question. Fruit and Nut trees that are "non listed horticultural plants" are covered by section DO 4 and can be amortised at 10%. The definition of non listed horticultural plants specifically excludes "a tree planted mainly for the purposes of timber production". I would argue the Pecan tree is planted mainly for fruit so is covered by DO 4. Development expenditure is not recoverable on sale and the purchaser can only continue to amortise whatever the vendor hasn't

amortised. This is irrespective of whatever might or might not be itemised in the agreement. The vendor would be safe but if the purchaser thinks they are purchasing standing timber they will be disappointed and only ever able to amortise whatever is left by the vendor.

Feasibility and water bores

Q: For the water bores if they gave up after the 3rd well and never found water could they still get a deduction?

A: In my view yes, under s DO 4 and amortisation rules. The failed bores are an "improvement" as defined in schedule 20 because the actual work and costs involved was the "sinking of bores or wells for the purpose of supplying water for use on the land" – even though there was no water found. The bore was sunk, and the purpose of the bore was for supplying water (despite no water found).

Child tax exemption under $2340

Q: If the child does some administration job such as filing/scanning for the company and receives income total under $2000 a year. The parents own the company. Is the income for the child exempt under s CW 55BB?

A: No. The work in this scenario is "employment income". There is no credible basis to argue that the child is engaged as an independent contractor. The child is a casual employee and PAYE should be deducted, therefore the s CW 55BB exemption does not apply.

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