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Residential land, co-owners & partnerships, refinancing options

Q: If you sell to LTC would you still suggest their new house being brought in a trust

A: Good question. There is no real need to buy their new house in a trust. If Lucy and Tom bought their new home in their joint names this is a separate entity from the LTC and sufficiently separate.

Q: Regarding IRD registration as Partnership - is it okay if the partnership applied for an IRD after the purchase of the property?

A: Yes, this doesn't cause a problem. In the webinar scenario Lucy and Tom bought the property in 2016, and it wasn't until June 2022 that they started renting it out. They would apply for a partnership IRD number in or about June 2022.

Q: Need clarification - can we still transfer to an LTC at market value? Assuming we are not worried about rollover relief? Assuming debt free.

A: Yes, there is nothing stopping you selling the property to the LTC at full market value. However, as you say it won't qualify for rollover for bright-line. In Lucy & Tom's scenario they could sell the property to the LTC at $850k (MV) instead of $700k. Because it is a New Build the interest on a loan of $850k would be claimable.
The gamble is that it is hard to predict the future and if it is sold within the bright-line period they will have a taxable gain.

Q: Should the funds of $700k be in the partners' current accounts rather than their capital accounts when set up?

A: As it wasn't sold into the partnership with a debt back, I would think the $700k is reflected in their capital accounts. Either way, the partnership can still refinance both current accounts or capital accounts and get the same answer.

Q: So, after all the analysis of the Partnership and LTC options and determining that both are doable what is the advice you are giving the client? ie. Partnership or LTC?

A: The webinar scenario is illustrating the point that there are choices and options. Then it is over to the particular client and their preferences as to which option is chosen. Not all clients want to set up a new company (LTC) and are happy with a simple partnership, eg. compliance cost reasons etc.

Q: How about if Lucy & Tom sell the new subdivided section (not the existing house), taxable or not?

A: The sale of the new section would not be taxable. Even if the subdivision work was more than minor, Lucy and Tom would be exempt under the residential exemption in s CB 17(2). Their property was less than 4500sqm and it was used as their family home. The section is part of the family home as it is their private lawn and grounds.

Portfolio analysis – FIFs, PIEs

CORRECTION

The Woolworths “distribution” is NOT taxable. There is a special provision in the legislation (sec ED 2B) that exempts certain ASX “spin outs” from tax as it is effectively a reduction in share capital, which is not taxable in NZ. There are a list of requirements that need to be meet to qualify for the tax free status – its very fact specific. If you want to know more about the facts for this particular spin out google “Woolworths Endeavour demerger”. The “distribution” is in fact the proceeds from the sale of shares in Endeavour (the subsidiary Woolworths spun out to its shareholders) with a corresponding reduction in the share capital in Woolworths. On a look through basis the shareholders of Woolworths owned the shares in Endeavour from the get go. So effectively the shareholder hasn’t received any distribution of profit, as the sale of the Endeavour shares equals a reduction in value of the shares in Woolworths value due to its reduced share capital. A copy of the legislation is at the end of this document and the relevant slides attached.

Q: I have a portfolio where the PIR rate at the front says 17.5% but all PIE deductions are at 28% - do we still have to do the washup?

A: If this is a Trust you will have to include in the return and top up to 33% unless it is distributed to beneficiaries. If it is an individual the IRD will do the square-up and if 17.5% is the incorrect rate (should have been 28%) based on the previous 2 years there will extra RIT if the PIE made a profit or reduced RIT if the PIE made a loss.

Q: If a Trust has MRP or Listed PIE investment income and PIR is 28%, but doing beneficiary distribution are we able to still include in TR for distribution to beneficiaries at their marginal rates?

A: Where a Trust <u>elects</u> 28% for a MRP it is always excluded so can not be allocated to a beneficiary. If it is a Listed PIE distribution that the Trust chooses to include this can be distributed to beneficiaries. So if the beneficiaries average rate is below 28% it makes sense to do this – good point to raise.

Q: Can PLE income/loss with 28% PIE tax be allocated to beneficiaries as well?

A: As above.

Q: PIE income/loss question: What is the purpose of allocating PIE loss to beneficiaries? can PIE loss be utilised to offset against other income? And can PIE tax be returned if PIE made a loss?

A: A PIE loss in a Trust (ie must have elected to zero to include in its return) cannot be allocated to beneficiaries – it must stay with the Trust, however if the Trust has other gross income e.g., rent and you want to allocate that to a beneficiary to utilise their lower tax rates and *keep the loss in the Trust for future income at 33%, this is allowable. A PIE loss in a Trust will offset other income in the Trust. There won't be PIE tax if the PIE loss is included in the Trust return as it must have elected zero to use the PIE loss.*

Q: Does the trust have to select 28% (i.e., can't be default rate?)

A: A good point. If a Trust does not elect a rate and the 28% default rates applies the income is no longer excluded. It could be allocated to beneficiaries but if not will be topped up to 33%.

Q: Just a comment - returning RWT etc over the amount expected just throws the return into review - send a secure email at the time of filing explaining why and the refund should be released OK

A: A good point to remember…perhaps one day the IRD system will have an automatic step or box to fill that will fix this!

Q: Can you change from cash to accrual from time to time or once you choose is that what you need to stay with?

A: A cash basis person can choose to account on an accrual basis and revert back to a cash basis in the future provided they are still under the thresholds. To do so requires a "cash basis adjustment" which effectively converts the arrangement to the method chosen as if that method was applied from the beginning. If enough people think an example of the "cash basis adjustment" is worthwhile we can do that in a future webinar email training@taxtonic.co.nz

Q: Hand out page 2 - FIF income (A) is positive say 10,000, then distribution 2,000 - this is same as myIR. So can I leave 2,000 as per IRD (instead of ignore) then just add 8,000 in the tax return then the total is 10,000. Thanks.

A: What you are saying is that the total income is correct but it's just technically not in the right boxes. I doubt IRD would have a problem with this but if you make a habit of it and there is a CV loss or there are foreign tax credits that might be claimable doing it this way could impact on the calculation of available credits and disadvantage the client.

Q: If client has 2 different investment portfolios, what happens if Portfolio A's FIF income shows CV is lower, but Portfolio B's FIF income shows FDR is lower? Can 2 portfolios use different FDR/CV method and declare whichever is the lowest?

A: Good question. Whichever FIF method is chosen for the year must be applied to all the person's FIF interest i.e., so in your example both portfolios would have to be either FDR or CV. You would need to add the results from both portfolios to see which gives the best result.

Q: So, I have clients whose FIF figures prepopulate their MYIR...should that be it, or do we still have to put numbers in. They actually prepopulate the PIE space

A: When you say "FIF figures" I am not sure how that is happening as neither the portfolio provider nor the IRD will know whether the person is electing to use FDR or CV. Just because a method gives the lowest figure in a portfolio that might not be the best answer for the client if they have other FIFs that make the other method a better option overall. If the actual FDR or CV results are prepopulating it would be interesting to see that. It could be something the Portfolio manager is doing wrong at their end. Have another look and if it is FDR or CV in MyIR you can send it to training@taxtonic.co.nz and we will cover it in a future webinar

Q: How unfair is the Tax Rule for Kiwisaver organisations and other portfolio organisations who have to run as a company. So, they are not allowed to use the CV FIF method. They have to use the FDR method every year, even if all their overseas shares subject to FIF have a negative year. Can we get the government to alter the rules to make it fairer?

A: Agreed. I'm not sure if you recall but originally the FDR method was going to be compulsory for all entities and it was only after extensive lobbying that the CV was introduced as a backstop for losses.

Q: I thought each FIF interest is a separate segment for FTC.

A: Yes, thank you for raising this. You are correct if it were dividends from the same country the dividends would be one segment but FIFs are specifically categorised as a separate segment. I will cover this point in more detail in the next webinar when we cover foreign tax credit rules in more detail.

Q: Just to confirm that the $50k for FIFs during the year is the cost value, not market value?

A: Good point and yes, it is the total of the original <u>cost</u> that must not exceed $50,000 at any stage during the year.

GST on assets acquired pre-registration

Q: If the land was originally brought off an unregistered person are you entitled to claim a secondhand goods input credit if you later register for GST?

A: The input credit is claimable (3/23rds of the cost of the secondhand good), however it is still subject to section 21B. The GSR input must still be spread as per the webinar example.

Cryptocurrency

Q: I have various currencies (crypto), all staked, in different entities. We get interest or "rewards" on them all. So, my argument is that the interest/rewards is taxable income, but the losses or gains are not. I'm willing to forgo the loss claim for a long-term plan

A: Yes agreed, with the interest income this is no different to shares so provided the facts do not suggest a trading or intention of resale aspect, the profits will not be taxable. Like shares it would be possible to have crypto in both camps i.e., long term holds for annual income and crypto for trading. Like shares it would be better to have the trades and holds in different entities.

Q: Crypto is not a financial arrangement for tax purposes? (i.e., return on a realised gains basis?)

A: Crypto has been a difficult asset to classify for tax purposes but IRD have concluded it is not "money" or a financial arrangement rather it is a commodity akin to Gold (subject to my argument that interest bearing crypto is more like shares for tax purposes)

ED 2B TRANSFERS TO SHAREHOLDERS BY ASX-LISTED AUSTRALIAN COMPANY OF SHARES IN SUBSIDIARY

ED 2B(1) WHEN THIS SECTION APPLIES

This section applies when—

(a) a company (the **splitting company**) is an ASX-listed Australian company under subsection (8); and

(b) shares in a company (the **subsidiary**) that is a member of the same group of companies as the splitting company (the **group**), are issued or transferred (the **share transfer**) to—

(i) shareholders of the splitting company or of a company that is a member of the group:

(ii) a member of the group; and

(c) the subsidiary is a member of the group immediately before the share transfer; and

(d) the share transfer is not a payment of assessable income or exempt income under the Income Tax

ED 2B(3) COST OF SHARES IN SPLITTING COMPANY AFTER TRANSFER

The cost for a shareholder of the shares in the splitting company that are held by the shareholder after the share transfer is the amount calculated using the formula—

cost before transfer × value after transfer ÷ (value acquired shares + value after transfer).

2B(4) COST OF SHARES IN NEW COMPANY

The cost for a shareholder of the shares acquired in the share transfer is the amount calculated using the formula—

cost before transfer × value acquired shares ÷ (value acquired shares + value after transfer).

ED 2B(5) DEFINITION OF ITEMS IN FORMULAS

In the formulas in subsections (3) and (4),—

(a) **cost before transfer** is the cost for the shareholder, immediately before the share transfer, of the shares in the splitting company held by the shareholder immediately after the share transfer:

(b) **value after transfer** is the market value of the shares in the splitting company held by the shareholder immediately after the share transfer:

(c) **value acquired shares** is the market value of the shares in the subsidiary held by the shareholder immediately after the share transfer.

ED 2B(6) AVAILABLE SUBSCRIBED CAPITAL AMOUNTS

Immediately after the share transfer, the available subscribed capital,—

(a) for each share held in the subsidiary, is—

(i) the amount given by section CD 43 (Available subscribed capital (ASC) amount) for the share; or

(ii) zero, if it is impractical to recognise an amount of available subscribed capital for the shares held in the subsidiary:

(b) for the shares held in the splitting company, equals the amount of the available subscribed capital for the shares in the splitting company held immediately before the share transfer, reduced by the total amount given by paragraph (a) for the shares held in the subsidiary immediately after the share transfer.

ED 2B(7) NOT DIVIDEND

The transfer of the shares in the subsidiary to the shareholders in the splitting company is not a dividend.

ED 2B(8) MEANING OF ASX-LISTED AUSTRALIAN COMPANY

ASX-listed Australian company means a company that—

(a) is resident in Australia; and

(b) is treated as resident in no tax jurisdiction other than Australia under each agreement that—

(i) is between Australia and another tax jurisdiction; and

(ii) would be a double tax agreement if negotiated between New Zealand and the other tax jurisdiction; and

(c) is included on the official list of ASX Limited, a market licensee under Chapter 7 of the Corporations Act 2001 (Aust); and

(d) is not an entity described in schedule 25, part B (Foreign investment funds); and

(e) is required under the Income Tax Assessment Act 1997 (Aust) and Income Tax Assessment Act 1936 (Aust) to maintain a franking account.

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