Tax-e-mail

DON'T LET THE IRD NAIL YOU

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School donations

Inland Revenue has produced exposure draft PUB00288. It discusses payments made by parents to state integrated schools and the extent to which these can be treated as donations for the purposes of tax credits. The important issue is that a child cannot be banned from the school if the parents fail to pay the donations. The effect of this is that the donations are voluntary even though everyone is expected to pay. It is common to set up special funds, such as "special character donation" and "building donation". Payments of these donations can be claimed for the purposes of the tax rebate.

The department has not produced an exposure draft dealing with non-integrated schools. If donations are made to a general fund and they are voluntary, the rebate can be claimed. However, if the donation is really in the nature of a fee for attending the school, it is not claimable for rebate purposes.

Bright line test – family trust

As you know, the bright line test does not apply to the family home. Similarly, if the family home is contained in a family trust and the main settlor and family live in it, the bright line test does not apply. However, if the home in the trust is made available to another member of the family and the settlor has a separate home, the bright line test does apply.

If the house is rented for part of the time and used as a home for part of the time, such as when the owner goes overseas for a protracted period, look at the percentage applicable to each. For example, the house is purchased on 1 April 2018. The owners live in it until 1 August 2018 when the owners go to Australia to take up a lucrative two year contract. The house is rented for the two years (or most of it) and then the owners return and live in it for a further five months. At that stage, they decide to sell. Do the arithmetic. The owners lived in the house for four months and later for five months, a total of nine months. The tenants lived in the house for two years. The house was therefore predominantly a rental and the bright line test applies.

Similarly, an Air B&B is caught under the bright line test if the predominant use is Air B&B as opposed to being a main home.

Bright line test only applies to "residential property". A property isn't residential if it is mainly used for business or as farmland.

Lease surrender payment - a revenue receipt.

Easy Park bought Whitcoulls building in Wellington in 2003. In 2011 it negotiated with its tenant for early surrender of the lease. Easy Park receive $1.1 million. The Court of Appeal confirmed this income was a taxable receipt.

The law has had a big overhaul in this area such that payments like these between landlords and tenants are always taxable. If they are during the lease term the amounts are spreadable.

Asset contributed as partnership share

Inland Revenue issued QB 17/09. If a client contributes an asset to a partnership, you could either have a full disposal or you could argue, as the partner would still own half the asset, there is a partial disposal. Inland Revenue says the contribution of an asset to a partnership is a full disposal.

GST – be careful with your timing

The Yellow Family Trust bought a property which it settled on 28 April 2017 as an unregistered person. In December it registered for GST commencing from 1 April 2017. This meant it was actually registered for GST at the time of settlement and therefore the original transaction should have been zero rated. Inland Revenue refused to pay the refund and it was left to the taxpayer to recover the money from the vendor. Watch the commencement date when registering for GST.

Could Yellow Family Trust have claimed GST if they had registered with the commencement date, for example, of 1 August 2017? Yes because the transaction would not now be subject to CZR there will be a GST content. This GST content can be claimed under the adjustment rules at the following two balance dates. If the balance date is March then at 31 March 2018 the property has been owned for 11 months and the trust has been registered for 8 months so 8/11 can be claimed then and the balance at 31 March 2019 or on disposal whichever comes first.

Foreign trusts made easy

We have noticed some tax specialist firms have been warning clients about the risk of some of the income coming from a foreign trust being taxable. This is our response.

Wills

A client is a beneficiary in a deceased estate. The assets are sold in the usual way and the resulting cash is distributed to beneficiaries. This amount is not taxable. It is common for executors/rixs to invest spare cash and derive some interest, while waiting to realise the balance of assets. The interest part of the distribution received is taxable.

Other trusts

As above, receipts in the nature of income are taxable. If they arise from unrelated party capital gains, they are not taxable. Return of the original capital (corpus) is also not taxable.

To clarify the nature of money received, you apply the ordering rules. This means it is assumed the first lot of money received is taxable income for the current year. When that is exhausted, the assumption is the distribution has come from retained income and is taxable. After that, you start to get to the unrelated party capital gains and finally the corpus.

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Donations

In Tax-e-mail 1809 we referred to distributions from charities. This is not absolutely correct. We should have talked about "applied" for the purposes of the charity. For example, the charity receives $1000 for the year and pays $750 for a computer. The $750 has been applied but it hasn't been distributed. It qualifies as safe harbour.

Choosing the right structure for rental property

Consider: asset protection, estate planning, taxation, compliance costs. The following table could help with your decision:

	Individual	**Company**	**LTC**	**Trust**
Asset protection	Bad	Good	Good	Good
Estate planning	Bad	Bad	Bad	Good
Tax effective – profit	Bad	Good	Bad	Good
Tax effective – loss	Neutral	Neutral	Neutral	Neutral
Compliance cost	Good	Bad	Bad	Bad

Distribution from a trading trust to a beneficiary

A GST registered trading trust would need to treat any distributions of its trading stock to beneficiaries as sales at market value.

IS 18/02 elaborates on its understanding of the law relating to such distributions. It goes into detail about when the time of supply is triggered. Generally, **for property** the supply of goods occurs when the beneficiary is able to remove **that property** from the premises. For immovable property (Real Estate) it is going to be the time of minuting the transfer. We recommend having a close look at the wording of this IS if you are dealing with a trading trust distributing goods or services to beneficiaries.

Trustees must include distributions to beneficiaries when assessing the need to register for GST.

PIE investments at banks

Not all PIE investments at the bank are investments with the bank. For example, some banks put their clients' PIE investments through a subsidiary company and they warn their customers the bank is not responsible for repayment. Unfortunately, this warning is not always as clear and upfront as it might be. This means it is not true to say the only difference between a term deposit and a PIE investment at a bank is the tax advantage. In the event of a financial disaster, the subsidiary company could be wound up, leaving the bank intact.

How to remember Bright-line timeline

There are three steps in purchasing a property:

- Signed sale and purchase agreement
- Agreement goes unconditional
- Registration of Title (normally Settlement)

Similarly, when selling a property you have the same three steps. For the standard purchase the bright line **period** runs from the third step of purchasing to the first step of selling. If it didn't, the date of sale could be manipulated.

Bloodstock – standout yearlings

A SOP has been added to the current Tax Bill before parliament. Effective from 1 January 2019 it is proposed to allow anyone who purchases, from a New Zealand premier yearling sale, to claim tax deductions as though they had a bloodstock breeding business. There will be conditions:

1. National minimum prices which have been set at:
   (a) $84,000 for standardbred yearling fillies; and
   (b) $109,000 for standardbred yearling colts; and
   (c) $467,000 for thoroughbred yearling fillies; and
   (d) $402,000 for thoroughbred yearling colts.
2. The IRD has to be notified of their intention to breed from the yearling for profit in the future and provide the owners' details.
3. The IRD will have to be provided with evidence, as required by the Commissioner, to support their stated intention. This would include a business plan.

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