



It's just too good to be true



December 2009



**Wishing you a safe and enjoyable
Christmas.**

**We appreciate your continued
support.**

**We will be closed from
21 December 2009
to
15 January 2010.**

If it's too good to be true - it probably is! So, when it comes to the Government subsidising taxpayers ownership of their family home via LAQC's it now seems it was!

The Taxation Review Authority ("TRA") has recently decided that a shareholder in a Loss Attributing Qualifying Company ("the LAQC") and the LAQC entered into a tax avoidance arrangement through her renting a residential home from it with the resulting tax losses being attributed to her.

In October 2007 Inland Revenue formally expressed its view that such arrangements were tax avoidance and invited taxpayers to make voluntary disclosures. It then wrote to the director's of LAQC's in October 2008 expressing its concerns and inviting voluntary disclosures where the family home was owned by the LAQC. It was, in our view, a case of too little too late. Inland Revenue has been aware of the issue for 15+ years and to only clamp down now on these arrangements now makes a mockery of tax administration in this country!

Judge Barber had no difficulty in finding that what the shareholder did was an arrangement and that each of the component parts of the arrangement entered into by the LAQC fell within the ambit of specific taxing provisions and regimes.

The judge then found that although the LAQC worked within specific provisions to alter the incidence of income tax, it did so in a way that would not have been contemplated by Parliament. The judge considered that Parliament would never have thought that LAQC's would be used by taxpayers to obtain deductions for expenditure that would normally be of a personal nature, being their accommodation and for shareholder's of LAQC's to then to gain a tax advantage by effectively receiving a deduction for what really was the shareholder's personal expenditure. After all, taxpayers owning their own home don't get a tax break!

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Barber DCJ then went on to find that the ownership of the family home in an LAQC was not commercially realistic and involved pretence which allowed the LAQC and the shareholder to manufacture an artificial business operation. The rental activity of the LAQC, said the judge, was not carried out on an arm's length basis as there was no external income coming from independent third party tenants.

The particular LAQC owned one asset - the family home - and there was only one tenant - the sole shareholder of the LAQC. All funds and expenses were sourced solely from her. This then was an arrangement of the most blatant kind.

The judge said that although the legal form of the arrangement was a separate legal entity he found that in terms of economic substance, the property was the private residence of the shareholder and the LAQC's tax losses were generated by tax deductions arising from the shareholder's expenditure that would normally be private or domestic to her and would not have been deductible but for the LAQC.

Partnership tax relief on death

In September 2008 the (then) government announced that it would alter the law to ensure that on the death of one of the spouses in a husband and wife partnership there would be no tax consequences.

At the last minute, the proposal was snuck into the HUGE July 2008 Tax Bill that was passed into law on 6 October 2009.

The problem

As a matter of partnership law, a partnership ceases on the death of a partner.

As a matter of tax law, when a partnership ceases each partner is deemed to have disposed of their interests in the partnership. This can result in depreciation recovery and deemed gains on the disposal of trading stock, livestock, trees and the like.

So, when it comes to husband and wife, civil unions and de facto couples

who are in partnership, not only did the deceased partner face a tax bill but so did the surviving partner.

The solution

With effect from the 2009 income year then, provided that:

1. The only partners are the 2 spouses; and
2. The partnership dissolves due to the death of one of the partners; and
3. The partnership interest is left to the surviving partner (not a life interest);

there will be no income tax consequences until the surviving partner sells the assets or dies.

The rule also applies to transfers of partnership interests under a relationship property agreement.

One who couldn't hide!

Inland Revenue recently came into information that a taxpayer had a credit card in a tax haven that New Zealand does not have an information exchange agreement with.

Unsurprisingly, Inland Revenue required the taxpayer to explain details of the card and all transactions made with the card.

When a client asks - "how will they find out"? The answer must be - "who knows - but the odds are they will!"

It is still getting harder to hide!

In November Inland Revenue entered into a further four information exchange agreements with tax haven countries.

This takes the number of such agreements to 11. Inland Revenue is proud of the fact that it has the highest number of such agreements in the world - there will be more!

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Having found that the arrangement was tax avoidance Judge Barber reduced the losses to nil and this increased the tax payable by the shareholder.

Inland Revenue has had considerable success in tax avoidance cases in the past 18-months and this decision of the TRA is probably the ammunition that it has been waiting for. The decision will motivate Inland Revenue to attack any LAQC that owns the family home. We expect that there will be an increase in activity in the New Year.

Hopefully though this case is not the end because there are still questions to be answered such as - what if the LAQC owned more than one property?, if the LAQC owns more than one property how many are okay?, what if a shareholder moves into a property an LAQC has owned for a few years?, what if the rental is occupied by the shareholder and his flatmates and all are paying market rent? Which of these situations are tax avoidance?

Despite the uncertainty and given the penalty risk (up to 100%) now may be a good time to review your LAQC clients where the shareholders live in a property owned by them. Each situation requires careful consideration and a judgment call!

ON THE SPOT ADVICE

Our telephone/fax/email consultation service is available to enable practitioners to deal with any questions as they arise.

TAX OPINIONS

Providing fully researched opinions on the taxation effect of transactions.

TAX AUDITS

Reviewing tax compliance requirements (FBT, GST, PAYE etc) to identify any deficiencies prior to any visit from tax inspectors.

TAX DISPUTES

Preparation of responses to disputes with Inland Revenue.