

# Tacks FAX



DON'T LET THE IRD NAIL YOU

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## Rentals – be careful

Clients who finance rental properties using 100% borrowed money and no repayments run a risk.

If clients have no intention of putting any of their own equity into the venture, it could be argued the prime reason for purchase is the gain in the value of the property and hence the profit at the time of sale is taxable. Recommendation: Warn clients of this risk and suggest they plan to reduce borrowing over time.

## Dividends when income tax is 30%

Companies paying out dividends, when the tax rate is 30%, will be required to make a three cents RWT payment for every dollar of dividend. Indications are it may increase to 6% after the next budget

## Share traders

Share trading clients, who have FIF investments of less than 10% in any company, will need to value their shares at their 2007 balance date using the FDR rules.

Notify IRD of the situation with the 2007 tax return. Any resulting additional tax can be spread over three years.

## Increasing 2008 provisional tax

Clients holding shares which will have dividends calculated using FDR, may like to increase provisional tax payments now to minimise UOMI. The problem is to identify them and tell them. If they hold shares in companies which have never paid a dividend, you will not know about them. To catch these risks, you would need to send a notice to all clients. If you send newsletters, you could include a flyer.

## Clients take out all their profits on sale of business

Clients, selling their business at a profit, usually take the capital profits out of the company before they consult us. If they do this, they have either borrowed the money or they have taken a dividend. In the latter case, if the company is a qualifying company and it has no or only a small amount of imputation credits, there is no tax issue. If it is not a QC, the payment could be a dividend and this would be taxable, unless the company had been put into liquidation. We see this example as another reason for making new companies QCs.

Remember if a QC becomes insolvent and goes into liquidation, its debts are deemed forgiven and become income. Shareholders have guaranteed the company tax so become liable to pay it. Deregistration, in good time, becomes very important.

## Limited Partnerships and rules for exiting partners

This legislation is to become effective from 1 April 2008. At present it is only a bill so changes are likely to occur. Here are some of the proposed law changes:

1. The limited partnership will have separate legal entity status
2. Limited partners will have their liability limited to the amount of their contributions
3. Any losses they incur will be tax deductible only up to the limit of the contribution.
4. Limited partners would not be involved in management, but would be able to have some say on how the partnership is run.
5. Streaming rules will apply to prevent the partnership from having an agreement designed to gain a tax advantage from using a Limited Partnership.
6. Partners will generally not need to account for tax upon exit if their profit above their share of book value of assets is no greater than \$50,000.
7. If the \$50,000 threshold is broken, there could still be some relief for exiting partners. The following adjustments may be ignored:
  - trading stock, if the trading partnership has a turnover of under \$3 million
  - certain types of depreciable tangible property, if the historical cost of any depreciable tangible asset held by the partnership is less than \$200,000.
  - certain types of financial arrangements, if the financial arrangement has been entered into as a necessary and incidental purpose of the business.
8. Where a partner buys in and the amount exceeds \$50,000 (the outgoing partner will have paid tax on the gain) he/she must use the price paid as cost and apply the same split of the asset as the outgoing partner used.
9. There is a 5 year spreading provision where livestock is bought.
10. Partnerships of 5 or fewer may elect not to use these rules so long as there are no limited partners.
11. Co-owners of property (not trusts and companies) and joint ventures may elect, for tax purposes, to bring themselves under the new rules.
12. Expenditure, incurred before the entry of a new partner and apportioned to the new partner will generally be tax deductible to the new partner.
13. Special partnerships continuing after enactment of the new rules will not be required to comply with the loss limitation rules.

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## **Section OB2 (2) and KiwiSaver**

In Tacks Fax 0706 we said "Shareholder/employees could also get the employer subsidy by making part of their income subject to PAYE." This needs clarifying.

Section OB2 (2) indicates that if a shareholder/employee derives two-thirds or more of his income from his company, then all his income should be subject to PAYE deductions. What if the PAYE salary is less than two-thirds?

A commonly held view is that in these circumstances the PAYE payments are no longer true PAYE payments but rather voluntary tax payments. It follows from this logic that it is not possible to take part of a shareholder/employee salary in the form of PAYE wages. While IRD appears to accept PAYE and provisional income for shareholder/employees, the department could insist on shareholder/employees, wishing to join KiwiSaver as employees of their company, taking all their income subject to PAYE.

## **Provisional tax 2009 and future years**

Clients who use the GST ratio, must put in GST returns every month or two months. They will pay provisional tax six times a year.

Those who prepare GST returns on a half yearly basis may not use the GST ratio method. These people will pay provisional tax only twice a year, in future. The dates for March balances are 28 October and 7 May.

The rest will pay their provisional tax three times a year on 28 August, 15 January and 7 May.

A Provisional tax form will be incorporated in the GST return.