



DON'T LET THE IRD NAIL YOU

Published by The Small Business Institute Limited

ISSUE 0909

Clients going to live abroad and their trusts

Inland Revenue has taken a concessionary approach to taxing trusts where the settlors live overseas. Some authorities claim its approach is not supported by the law. Therefore, accountants and their clients rely on it at their own risk. Broadly speaking, provided a trust continues to pay all its NZ taxes as though the settlors were still residents and it is not in receipt of any foreign income, the department is happy to allow a trust to continue to be a complying trust. If it does get foreign income, it must pay tax at the normal rates and cannot pay NRWT on interest and dividends paid to beneficiaries.

There is a time limit for making an election to maintain complying status, when settlors are moving overseas. It is the time for filing a return when the trust first becomes non complying. A client left NZ on 27 February 2009. If the trust derives foreign income, election must be made in the time allowed for furnishing the 2010 return, because this is the first year the trust ceases to be complying.

For NZ complying trusts with migrating settlors it might be prudent to remove all foreign investments and retain the trust as a complying trust with solely NZ investments.

Non complying trusts are taxed at a 45% rate on distributions of capital gains and accumulated profits. Look at the trust's balance sheet. Are there capital profits or potential capital profits there? Is there a significant accumulated profit? Does the trust (or might the trust) own foreign investments? If the trustees open a savings account for the trust where they live and have not elected to maintain complying status, they have converted the trust into a non complying trust.

To apply to have the trust continue as a complying trust, use form IR 463. The trust would then pay tax on its foreign income, as though it were an NZ resident.

For more details on this subject refer to TIB Vol. 1 No 5.

Old rules apply to trusts settled before 17 December 1987

Standard advice

Clients should always be told to get advice from an accountant in the country they are going to live in. This advice should be top priority. For example, Australian tax law on trusts is very different from ours.

Tax avoidance

It is no longer safe to rely upon the Duke of Westminster case. The new anti-avoidance section is vague.

Section YA1 of the Income Tax Act 2007 states

"Tax avoidance includes (b) directly or indirectly relieving a person from liability to pay income tax or for the potential or prospective liability to future income tax."

This is just one of the three parts to the definition of tax avoidance.

If clients want to enter into any arrangement which provides a tax advantage, consider warning them, in writing, of the risk. The law is vague and wide open for the IRD to interpret it as it thinks appropriate.

Tax law is not static. What appeared to be fine yesterday could be avoidance tomorrow. If you have been giving advice, which might now be able to be interpreted as avoidance, this is a good time to review it.

You don't want to have to argue with IRD. The cost of genuine people protecting their innocence is the unfair side of tax law.

If the scheme smells like tax avoidance, it may well be just that.

Cash basis non individual

From the start of the 2009 financial year companies and trusts can account for income from financial arrangements on a cash basis, subject to various thresholds. For the purposes of determining the \$1 million threshold what do you have to look at?

Consider this list:

1. Advances from settlors
2. Shareholder current accounts
3. Debts owing to beneficiaries
4. Debtors and creditors
5. Unpaid dividends credit in account
6. Shareholder funds
7. Mortgages

The only item in the list which could not be a financial arrangement is shareholders' funds. The rest could be. Look at the definition of a financial arrangement and the list of excepted financial arrangements. Refer to S. EW 3 of 2007 Income Tax Act. Debtors and creditors under 93 days are not financial arrangements. Variable principal debt instruments (VPDIs) are exempt, subject to the rule of the total VPDIs not exceeding \$50,000 on any day in the year. Include the following as VPDIs: Call Accounts, Shareholder Current Account and Beneficiary Accounts.

Advances from settlors would be OK so long as they are interest free and repayable on demand. Just make sure the appropriate wording is in place.

Remember you add the liabilities to the assets for the purpose of this threshold. If you are well under the \$1 million don't worry. If your client is marginal, make sure all "i's" and "t's" are dotted and crossed for those accounts you want to treat as not being financial arrangements.

Tax refunds and GST ratio

Tax refunds, resulting from using the GST ratio, are being held up by IRD if "standard" is selected for provisional tax. Choose the new option called "Ratio".