



May 2007

NSA ON TAX

New Look NSA

Inside this issue:

New Look NSA

You'll be noticing some changes at NSA over the coming few months. We're rebranding and moving to new

premises on 1 July 2007. More information will come closer to the time.

Dividend or FBT?

Dividend or FBT?

Financial Arrangements – Foreign Bank Accounts

Often an area of much confusion is whether a transaction falls under the dividend rules or the FBT regime. Let's consider the provision of interest free loans for example. Whether the dividend or FBT rules prevail will depend on who the parties involved are.

dividend rules. However, this election cannot be made in respect of low interest loans.

Subsidies and Grants

Subpart CD of the Income Tax Act 2004 ("the Act") deems a dividend to arise to the extent that an interest free or low interest loan is provided to a shareholder or an associated person of a shareholder.

In addition there is an anti avoidance provision in section GC 15 of the Act that was inserted to cover the situation of a non cash benefit received by persons associated with an employee. The associated person is deemed to be an employee for the purposes of section GC 15. An exception exists where the associated person is a company and the employee is also a shareholder in the employer company.

Dividends that arise from low interest loans may be excluded from the dividend rules if they are "downstream". There are certain criteria that must be satisfied for low interest loans to be excluded as downstream.

Therefore two companies that are wholly owned may come within the provisions of section CW 10 to exempt the interest free loan from being a dividend. However the application of section GC 15 could mean that the FBT rules take precedence and an FBT liability exists.

There is a further exemption contained in section CW10 of the Act that deems dividends between New Zealand tax resident members of a wholly owned group to be exempt.

You should therefore ensure that advice is taken if you are concerned this situation may arise, as IRD audits commonly focus on the tax treatment of intercompany loans.

Consequently if a low interest loan is downstream or between wholly owned group companies no issue arises right? Not necessarily.

We note that the FBT rules take precedence over the dividend rules although in some circumstances an election can be made to apply the

Lisa Murphy

Level 5
345 Queen Street
Cnr Queen St and Mayoral Dr
Auckland

Ph: 09 309 6505
Fax: 09 309 6506
Email: nsa@nsa.co.nz
Website: www.nsa.co.nz



Contact Details

DIRECTORS

Phillip Walker
Philip Bell
Bruce Watt
Graeme Carruthers
Keith Turner

ASSOCIATE

Lisa Murphy

PHONE

(09) 309 6505

FAX

(09) 309 6506

EMAIL

nsa@nsa.co.nz

WEBSITE

www.nsa.co.nz

ADDRESS

Level 5
345 Queen Street
Cnr Mayoral Drive &
Queen Street
PO Box 3697
Auckland

Financial Arrangements – Foreign Bank Accounts

Were you aware that if you are a cash basis person under the financial arrangement rules then foreign exchange (fx) fluctuations must be accounted for each time a withdrawal is made from a foreign bank account?

Don't worry, we weren't either but according to one Inland Revenue Department (IRD) office, fx gains and losses must be brought to tax when a withdrawal is made – which could be daily.

It has always been understood that a cash basis person may determine income derived or expenditure incurred on a cash basis using the rules outside Part EW of the Income Tax Act 2004. Alternatively a cash basis person could elect to use a spreading method. Either way a base price adjustment is performed when the arrangement is sold, transferred, matured or remitted.

Consequently a cash basis person with a foreign bank account would ordinarily not account for fx fluctuations until the account was closed or the majority of the funds withdrawn. If the cash basis person meets the “variable principal debt instrument” (VPDI) exemption, the bank account would fall outside the

financial arrangement rules completely. This is where the total value of all VPDIs does not exceed \$50,000 on every day in an income year.

The result is that a New Zealand resident with £2,000 in a UK bank account and no other VPDIs would only account for any interest income received (converted to New Zealand dollars of course). Even if the VPDI threshold was exceeded, fx fluctuations would only be taxed when the account is closed or significant funds are withdrawn leaving the account effectively closed.

The IRD disagree with this and consider that a running balance converted to NZD at spot rate (or IRD rates) must be kept which is compared to the actual converted balance at year end at the year end conversion rate. If this results in a gain, the individual must pay tax on it.

In our view this is wrong and we would be interested to hear if any of you or your clients have struck similar treatment from the IRD.

Lisa Murphy

Subsidies and Grants

In the IRD's March GST News it is stated that:

“Your business or organisation may receive a grant or subsidy from the government, local authority or a private organization. These all include GST and must be included as income for GST purposes.”

This is not strictly correct. Only grants or subsidies from the government or any public authority

are deemed subject to GST (sections 5(6D) and (6E) GST Act 1985).

Grants or subsidies from private organizations to non profit bodies are not subject to GST, as the grant is not made in consideration for a supply of goods or services, and such grants are also likely to qualify as unconditional gifts.

Keith Turner