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Dividends and Resident Withholding Tax

From the 2008/09 year, the corporate tax rate was reduced to 30% and the imputation ratio capped at 30/70.

However, the rate of resident withholding tax ("RWT") has remained at 33% for companies making distributions of resident passive income in the form of dividends.

The result is that the company paying the dividend has an obligation to pay 3% of RWT to the IRD by the 20th of the month following the dividend distribution.

This adds an unwelcome level of additional compliance for corporates. IRD say they are considering the issue.

Advisers will need to give serious thought as to how to address this at year end. Many taxpayers wanting to pay a dividend at 30 March 2009 to clear current accounts will not have sufficient financial information to determine the level of the dividend. Late payment of RWT could expose the taxpayer to use of money interest and penalties.

It could be that taxpayers are having to base 2009 year end dividends on management accounts and estimating the dividend to eliminate exposure to late payment of RWT.

Keith Turner**Amalgamations – the pitfalls and benefits**

Amalgamations of commonly owned companies are sometimes overlooked as a simple and effective means of reducing compliance costs and potential tax liabilities. In today's gloomy economic environment and with the crash of many finance companies, liquidation is often an unavoidable outcome. One benefit of amalgamating companies is that you can reduce liquidator costs. Why liquidate 5 companies when you could amalgamate and liquidate one. The costs of amalgamating 5 companies into one will most certainly be less than liquidating those 5 companies. Of course, any tax issues facing amalgamated companies must firstly be dealt with.

Amalgamations can be useful where loss offsets have occurred between group companies resulting in unimputed retained earnings in the profit company. Unimputed retained earnings give rise to a resident (or non resident) withholding tax liability on eventual liquidation. Amalgamations can assist in mitigating such liability.

There are some traps of which to be aware. One of these is the tax treatment of any intercompany borrowings between amalgamating companies where the borrower is insolvent. If an amalgamating company that is a borrower is insolvent on amalgamation, the debt owing is deemed to be discharged for consideration equal to the market value of the financial arrangement. This gives rise to income to the borrower on the triggering of a base price adjustment.

We have seen many instances where this rule has been overlooked. There are mechanisms that can be used to overcome this potential

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liability where the borrower is insolvent, but it is much more difficult, if not impossible, once the amalgamation has occurred.

At nsaTax Limited we can assist you with the amalgamation process from planning to documentation. We also have a comprehensive paper on amalgamations including checklists and documentation templates. If you require any assistance in this area, please contact the writer.

Lisa Murphy**Tax Changes for General Partnerships**

The new limited partnerships regime was brought into existence in April this year. However, the amending legislation also introduces tax changes for general partnerships, with officials stating there was a need to “clarify and modernise” the tax treatment of general partnerships.

Indeed the previous rules were somewhat unclear, particularly around areas such as when a dissolution occurs, the tax consequences on dissolution and treatment when a partner enters or exits a partnership.

Tax changes for general partnerships contained in the new rules include:

- Clarifying the ‘flow through’ effect of the partnership activity to each partner in proportion to their share;
- Anti-streaming rules for income, gains, tax credits or similar (with some exceptions)
- Deemed market value disposal of partnership assets on dissolution of the partnership.
- Requirement for exiting partners to account for income arising on disposal unless they meet disposal safe harbour thresholds.
- Generally, if there will be less than \$50,000 income arising to an exiting partner, they will not be required to account for income.
- There are also safe harbour thresholds for trading stock, depreciable property, financial arrangements, short term agreements for the sale and purchase of property or services and livestock.
- Anti-avoidance rule deeming transactions between partners to occur at market value where there has been arrangement.

Please contact any of the nsaTax Consultants if you have any specific queries on this area.

Maggie Jaques**Products for Sale**

FIF Guide for the new rules -
\$350 plus GST

Please contact Nicki Watson,
nickiw@nsatax.co.nz to obtain a
copy

Business Valuations and Capitalisation Rates

I am not infrequently asked to comment on valuations in the course of providing litigation support services. The “Benchmark” standard is of course AES-2. In a recent case the valuation report stated “after considering all the factors we believe the capitalisation rate to be...”. No workpapers were available to support the capitalisation rate used. Whilst calculation of a capitalisation rate is arguably one of the most difficult and subjective areas of valuation, there is nevertheless the requirement to provide support for the rate/s adopted. In the case of SME’s and in the absence of comparable market data the “build-up” or

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summation method offers a supportable and defensible approach.

The method adopts a risk free tax rate of return then adds various investments to reflect the degree of risk inherent in the investment as detailed in the table below.

Build-Up Capitalisation Rate

Risk Free Rate

+ Equity Risk Premium

+ Specific Company Risk Premium

= Discount Rate

- Long-Term Growth Rate

= Capitalisation Rate

The current market yield on long term government bonds is typically used as a proxy for a risk free rate of return.

Any equity risk premium recognises the additional risk, over and above the risk free rate, associated with investing in a large portfolio of publicly traded shares.

The specific company risk premium takes into account all the factors specific to the subject business e.g. reliance on key personnel, supplier relationships, future prospects etc.

The sum of all of the above, after allowance for a long term growth rate provides a supportable method for calculation of a capitalisation rate.

Bruce Watt**Section 46 (5) of the GST Act 1985; The tale of the Indian Giver**

Where a taxpayer claims a GST input credit in a GST return, it often happens that the IRD decide to audit the GST return which gives rise to the GST refund. In most cases the audit will centre on issues relating to whether expenditure claimed is genuine, or whether in the opinion of the IRD, the taxpayer has a 'taxable activity'.

By virtue of the self assessment regime which now prevails, when the taxpayer files the GST return in the IRD office, an assessment is immediately generated. Where the assessment translates into a GST refund, this means that as the assessment is in the taxpayer's favour, payment by the IRD must follow. One would think that in such cases, the IRD would be as quick to make a refund as it would claim payment where it is the taxpayer has GST to pay.

In terms of section 46(5) of the GST Act 1985, unless the IRD issues a notice within 15 days working days of the receipt of the return indicating that the IRD intends to investigate the circumstances of the return under section 46(2) and withhold payment of the refund under section 46(3), IRD must issue the refund. Where the IRD successfully does this, the input credit is held up until either agreement is reached or the disputes process is completed. Where the IRD does not manage this, they must pay the GST refund to the taxpayer forthwith, but of course may thereafter still continue with the audit. Although section 46(5) does not stipulate that the notification has to be in

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writing, one needs to have regard to section 14 of the Tax Administration Act 1994 to properly apply the section. Section 14 provides that where the Commissioner needs to give notice in terms of any statute, it needs to be in writing.

Taxpayer's will naturally be concerned that the IRD complies strictly with the provisions in section 46(5), as the consequences can be quite dramatic, and the difference between an immediate payment and a delay which could be months or even years as the dispute drags on until a decision is reached. The IRD could also theoretically wait almost 4 years before even commencing with the dispute.

A real life example will illustrate the point; a taxpayer buys 2ha of commercial land for \$8m plus GST of \$1m in August 2007. The agreement is unconditional, and the time of supply is accordingly triggered when the deposit is paid (on signature). The parties agree that the vendor's GST will be paid by the purchaser by way of an offset.

After the purchaser files its GST and claims the GST input credit of \$1m, the IRD indicates verbally that it intends to audit the return and withhold payment of the GST refund. It purports to do so in terms of section 46(5). It then commences an audit and in June 2008 completes the audit but concludes that the purchaser has no taxable activity, and notifies the purchaser that it intends to commence the disputes process. On average, a dispute can take about 18-24 months to reach resolution; the purchaser will only get the GST input credit if it succeeds in the dispute.

In the meantime the vendor is insisting on payment of the GST and is threatening to cancel the agreement by virtue of the non-payment of the GST. The IRD has in the interim added about \$300,000 to the vendor's GST by way of penalties and use of money interest.

In this case the matter had a relatively happy ending as the IRD finally accepted that a verbal notification in terms of section 46(5) was invalid, and so a commitment has been made to release the refund, which should reverse the penalties and interest levied. However the IRD had itself overlooked its failure to issue a written 46(5) letter within 15 working days, and had the issue not been raised by the taxpayer, the IRD would have held onto the GST refund, (unlawfully as it turns out), with possible irreparable repercussions for the taxpayer. In the interim the audit will continue, with the IRD still insisting that the purchaser has no taxable activity, and seeking repayment of the \$1m GST input credit from the purchaser.

Timothy Chemaly

Seminars

We are running a special seminar on Tax Disputes Process – Know Your Rights on 30 July.

This seminar focuses on the tax disputes process. We will cover issues that you need to be aware of when dealing with the IRD, your rights and obligations, drafting of dispute documents, common traps to be aware of and tips to make the process easier.

If you wish to register please see the registration form attached within our newsletter e-mail.

Lara Hartmann