

**July 2009****Inside this issue:**New Associated Persons  
Rules... A Step CloserOver Imputing Dividends  
During the Transitional  
Period

QCs &amp; LAQCs

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**New Associated Persons Rules... A Step Closer**

As reported in earlier editions of the nsaTax InBrief, the Government intends to make sweeping changes to the definition of “associated persons” in the Income Tax Act 2007. In this article we update you on the proposed changes. The effect of the changes will significantly widen the scope of who will be deemed to be an “associated person” and will also replace the definition of a “related person” with this definition. The change is particularly relevant for builders, property dealers or developers as other entities are likely to be “tainted” by association. This means that gains derived on property that is sold within 10 years of acquisition and owned by a person or entity that is associated with a builder, land developer or dealer, may be taxable if the land was purchased after the date of enactment. The intention behind the new law is to close perceived loopholes in the current definition but in doing so, the Government will put in place an extremely broad definition. The Bill containing the changes has been working its way through the Parliamentary process and the Finance and Expenditure Select Committee recently reported back to Government on the 26 public submissions opposing the changes, including our own.

We were pleased to see the Committee has recommended a number of changes and amendments to clarify aspects of the new law. In particular the ambit of the “relative” definition has been narrowed from the initial proposal of within four degrees of blood relationship to within two degrees of blood relationship. Also a proposed new test for an associated person being defined as “habitually acting in concert” has been removed altogether.

However the proposed definition of an “associated person” for the purposes of the land provisions remains very wide, reflecting the Government’s clear intention to ensure that few structures can be employed by which a builder, property dealer or developer will not taint their other property holdings. It was notable the Committee rejected any suggestion that such persons could hold land on capital account as well as revenue account and that generally any gains on land sales by such persons are taxable.

The key features of the Bill in relation to land transactions are new tests in relation to trusts where unlike the current associated persons tests, two trusts will now be associated via a common settlor. Also, new aggregation rules for companies mean that a company and another company or a company and an individual will be associated through aggregation of interests held by close associates, effectively a look through test. Another significant change is the introduction of a “tripartite test” that will operate to associate two persons who have a common association with third parties. However the Committee did recommend amendments to the “tripartite test” to narrow its scope.

Overall the new law will make the whole regime much more difficult to implement structures that avoid tainting issues and will require careful review of such issues before land transactions are entered into by persons that hold land on revenue account. The new rules for land transactions will apply to any land acquired on or after the date of enactment, which is expected to be later this year. The remainder of the associated person changes have been delayed and will now apply from the 2010-11 income year.

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The key message for our clients is to consider what impact these changes may have and we encourage those considering purchasing land to look at existing structures carefully, especially given IRD's stated compliance focus on land transactions. Once the new law is enacted there may be few (if any) options available to avoid a tainting problem so action should be taken now.

**David Weaver****Over imputing Dividends during the Transitional Period**

With the change in tax rate to 30% and the imposition of Resident Withholding Tax (RWT) on dividends fully imputed at 30%, a number of questions may arise as to how to best manage your client's Imputation Credit Account (ICA) and payment of dividends during the transitional period. At nsaTax we have been asked to comment on a number of different scenarios and the following questions need to be considered.

- What is the balance of the 33% ICA? Has it been utilised and do any excess imputation credits exist?
- What 30% ICA credits are available and what is the RWT liability that will arise if dividends are fully imputed at 30%?
- Has the ICA balance been reconciled to retained earnings?
- Are there any issues regarding overdrawn current accounts at 31 March 2009 and how do we resolve these? Does the company need to declare a dividend?
- Can we pay a dividend at the ratio of 33/67? What if the company only has 30% ICA credits?
- What are the costs involved with the various options, i.e. over imputing a dividend versus paying RWT?
- Will the company suffer an imputation penalty and if so, how is that calculated and when is the payment due?

We have developed an ICA workpaper that will assist you in tracking your client's ICA balances during the transitional period and provides a checklist of issues to consider as well as a worked example regarding the calculation of imputation penalty tax when a dividend is over imputed. If you have not yet found the time to develop one of your own then our workpaper can be provided to you at a small cost. Contact us if you are interested in obtaining this.

**Lisa Murphy****Qualifying Companies and Loss Attributing Qualifying Companies**

In our August 2007 issue we discussed the liability of shareholders of a qualifying company for tax payable on remission income arising from the liquidation of a company.

Remission income can arise when a company is released from a full or partial obligation to repay creditors or loans. This is becoming a more significant issue in the current climate.

Where the company is a qualifying company, the shareholders are personally liable for their share of any unpaid income tax of the company. Therefore the shareholders need to consider revoking the QC/LAQC

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status of the company if the company is unlikely to be able to pay the income tax.

Ideally they should make that decision before the appointment of a liquidator. We are aware that the IRD has a view that once the liquidator is appointed, the shareholder cannot revoke their QC election as section 248(1)(e) of the Companies Act 1993 says that once a liquidator is appointed, the shareholders' liabilities cannot be altered. We consider that the liabilities referred to are those between the company and the shareholder under section 97 of the Companies Act, not the shareholder and third parties, but the issue has yet to be tested.

There are other ways a company can drop out of the QC regime, such as revocation of a director's election or a change in shareholding, but neither of these can be done once a liquidator is appointed.

A reminder too that there are strict rules and timelines for a company becoming a QC/LAQC and maintaining that status. The IRD gives no leeway for oversights that affect the company's QC/LAQC status.

These are some of the issues we see crop up now and again which are sometimes overlooked:

- Losses carried forward by a company are forfeited on becoming a QC and cannot continue to be carried forward. The forfeited losses are not reinstated if the company later ceases to be a QC.
- For an existing company an election cannot be made retrospectively. The notice electing to be a QC/LAQC must be received by the IRD before the commencement of the first day of the year for which the company is going to be a QC. A late notice would be effective from the start of the next year, and any losses incurred in the earlier years would be lost.
- For a new company the election must be made within the time for filing the company's first income tax return. This would be to the extended due date if the company has an extension of time at the time of making the election.
- If a trust is a shareholder, dividends paid to the trust must be passed out as beneficiary income. Overlooking this revokes the company's QC status and can have adverse consequences for later dividends if they are paid out in the mistaken belief that the company was still a QC.
- A change in shareholding may require new elections to be made within 63 days of the change.

For more help or guidance refer to your nsaTax consultant.

**Gavin Stewart**