

SPECIAL EDITION**March 2010****Inside this issue:**LTC Special Update – When
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LAQC Transition Kit

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LTC SPECIAL UPDATE – WHEN IS A TRANSPARENT ENTITY NOT TRANSPARENT?

Some of you may recall comments made in our recent series of seminars and webinars about the nature of LTC's and in particular whether the "transparent" nature of an LTC meant we ignore certain transactions between owners and the LTC.

At nsaTax, we were strongly of the view that ignoring transactions between owners and the LTC was not a correct interpretation of the law. However, a number of other tax advisors running similar LTC training sessions took an alternative view to ours.

The best way to explain the issue is by way of simple example. Let's assume an individual is in business as a sole trader electrician. The business has grown significantly to the point where the individual has determined that the level of business risk involved now warrants the protection of limited liability. The individual chooses to transfer the business to an LTC in which the individual owns 100% of the shares.

The LTC borrows \$100,000 from a bank to fund the acquisition of the business, plant and equipment, etc. The LTC acquires the business from the individual, who uses the funds to repay private debt.

Is the interest on the funds borrowed by the LTC tax deductible?

Some advisors took the view that one of the consequences of being fiscally transparent is that the individual owner is treated as holding the LTC's property and carrying on the LTC's activity. This aspect nsaTax agrees with. However, those advisors go on to state that the individual's entitlement to interest deductions must be determined on the basis that he has not transferred the business to a separate legal entity. They consider fiscal transparency means you effectively ignore transactions between owners and the LTC. As a result, no deduction for interest is available because the actual use of the borrowed funds is to repay private debt. It is this latter view we disagree with.

The plain words of the legislation state that anything the LTC does is deemed to have been done by its owners. In our example, the LTC has borrowed funds to acquire the business and therefore the correct (read nsaTax's) interpretation of the legislation is that the individual shareholder is deemed to have borrowed \$100,000 from the bank to acquire the business. This means interest deductions are available and the fact that the borrowed funds were ultimately used to repay private debt is irrelevant. Also, the fact that the business was purchased from the individual (who is also deemed to have acquired it) is also irrelevant.

We are pleased to advise that our interpretation is correct and that this has been confirmed by Inland Revenue's Policy Advice Division.

We are about to lodge two further submissions – one on the calculation of the initial owners basis in the transitional year and the other on the calculation of "secured amounts". Look out for future LTC Special Updates for the result of those submissions.

Finally, we are in the process of designing a spreadsheet with comprehensive notes to calculate the owners basis. We hope to have this available for anyone interested by 31 March.

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LAQC's – Where to From Here

Is your firm needing help or support with the recent LAQC changes? If so please [click here](#) to have an nsaTax consultant contact you to arrange a time to come and see you regarding the recent changes.

LAQC Transition Kit

Business Fitness NZ Limited has got your LAQC transition process covered by an approved nsaTax Transition Kit which contains all the decision trees, checklists, client acceptance letters and implementation checklists you need to ensure a smooth LAQC transition. Below are some of the testimonials they have received.

Sheryl Holland, Middleton Holland & Associates Ltd:

"The Business Fitness LAQC Kit has great letters to send to clients and we found the decision tree very helpful. It was just what we needed."

Debbie Ogier, Ogier Chartered Accountants Ltd:

"While it's still early days for us with LAQC transition for clients, we're confident that Business Fitness NZ's LAQC Transition Kit positions us to offer a high quality service to clients affected by the LAQC legislation. We've already been approached by another firm to take on their LAQC Transition work as well. This is an exciting opportunity we feel well equipped for with the systems and tools in the kit."

[Click here](#) for a full list of what is included.

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