



DON'T LET THE IRD NAIL YOU

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Failure to elect a PIR

PIEs are required to send a notice each year to investors to get a fresh PIR (tax rate to use in the PIE). If the investor fails to provide a PIR, the PIE uses the 30% rate. Suppose the investor is a trust and a PIR of 30% has been used, being the default rate. 0% might have been a better choice if the trustees wanted to distribute income to the beneficiaries. If the trust has not made an election and the default tax rate has been used, the income from the PIE is probably not excluded income and would therefore be taken into the trust's tax return. The issue could be what constitutes making an election? If the client is using a financial advisor, that person might be deemed to have elected as agent.

Clients building office on to home

We will probably encounter more clients running their businesses from their home in the next while.

If the client wants her company to own the new building, what are the consequences?

- The individual needs to lease the land to the company at market rental.
- The lease needs to be reviewed regularly, as would occur if the transaction was between unrelated parties.
- If lease ceases then an FBT or deemed dividend situation arises because the land owner legally acquires the building.
- When the lease ceases, the company will have the usual consideration of depreciation recovered.
- If the value of the building has gone down, any loss is not deductible.
- Make sure your client keeps a lease in place while she stays in business.
- If the lease ceases, for GST purposes, a supply will occur at market value. A formal valuation will be needed for such a difficult situation.

If the client were to build the office herself, there could be less hassle. However, having the company do the building might assist in keeping a positive balance in the shareholder's current account.

Time to top up?

Some clients may need to top up their provisional tax. This is a good time to check. Many who get you to do their GST returns will now have 10 months figures in your computer. You could guess their 12 months income and, if required, get them to top up their provisional tax.

Some will need the reverse – to estimate provisional tax downwards. You might also do them a favour by telling them of their right to estimate tax, while warning them of the risks.

Rental and LAQC

Opinions vary on the wisdom of selling the family home to an LAQC when the client wishes to retain it for rental. The usual scenario is to take a substantial mortgage in order to get as much money as possible with the hope of having the new family home unencumbered as quickly as possible.

Some accountants rely on the Duke of Westminster case, which gave us the principle that a taxpayer, who has not previously been in business, is entitled to arrange his/her affairs in the most tax effective way. Times change. Some consultants consider the Commissioner might not accept this argument for selling a home to an LAQC. We recommend the following:

1. If the client wishes to go ahead with the arrangement warn him/her of the risk and document you have done this.
2. Your client should be able to show the LAQC situation will be a genuine rental, ie there will be a cash surplus (case law indicates a taxable profit may not be needed), within a plausible period of time. The client should also be able to show the sale would have been no different from selling to an outside party.
3. Consult you tax specialist

OB 2 (2) rewritten

The rewritten Income Tax Act (2007) contains a change to the rules relating to shareholder-employee salaries. Leaving out intervening words S. RD 3 reads:

Subsections (3) and (4) apply for an income year when a person is a shareholder-employee of a close company, and—

(b) an amount is paid as income that may later be allocated to them as an employee for the income year.

Subsection 3 reads:

The person may choose that an amount paid to them in the income year in their capacity as employee of the close company is not a PAYE income payment.

Subsection 4 is the same except it relates to future years. We think IRD may have tidied up a messy section and acted consistently with the policy stated when the GST ratio was introduced. The change encourages shareholder-employees to pay tax as they go. Our reading of S RD 3 leads us to believe a PAYE salary and an additional provisional tax payment are now permitted. The two-thirds rule appears to still apply.

The change may be unintended and therefore corrected. The correction of unintentional changes may be backdated. Be careful if you rely on this change. IRD is about to announce penalties for taking advantage of unintended changes resulting from the rewrite.