

TRADING PROPERTY HAVE YOU GOT IT RIGHT ? - Part 2.

In last month's magazine I wrote the first part of this article about property trading. This article will complete this subject.

The best business structure

In my experience the best business structure to trade property is a trading trust, with a corporate trustee as the sole trustee. The reasons are that this type of trust can achieve:

Non 'tainting' of any buy and hold properties, owned in another of the same family's business structures (providing the beneficiaries are chosen appropriately). Tainting needs to be avoided at all cost, because if any 'association' of persons or structures is created, which 'taints' any associated buy and hold properties, then on the sale of any of these 'tainted' buy and hold properties, capital gains will be denied, and the property will be taxed on the full profit, in the same manner a trade will be taxed. There is also the risk that 'tainted' properties may be classified as trades by IRD, and assessed for GST only on the sale, with no claim being possible on the purchase price.

The profits made in a trading trust, gain better protection than those profits made outside trusts (by companies with shares owned personally, or alternatively profits made personally) and the profits can be handled in the most flexible manner. These can either be

- distributed to other, tax loss making buy and hold trusts,
- or distributed to a wide range of individuals,
- or distributed to registered charities which include churches, completely free of tax to the trust, and completely free of tax to the charity,
- or held in this trust after paying 33% trustees tax.

The use of a corporate trustee (the clients own trustee company), achieves limited liability protection 'at the coal face' for all transactions.

Taxation and GST Issues and Traps for Traders

The structure will have to be correctly registered for tax and for GST. All trading with turnover greater than \$40K p.a. other than the trading of financial instruments such as shares, futures etc., must be registered for GST. It is vital that the sale and purchase agreement is correctly completed in all respects. This is particularly relevant for the GST section, to be certain that the correct alternative is selected. My advice is before the offer is signed by the trader, it should be checked first by a Lawyer, experienced in property and GST issues. It is normally best to register with a one month cycle, so that the expected refund of 1/9th of the purchase price of the property, can be applied for without undue delay. There are large refunds involved, for example 1/9th of a purchase of a \$225K property is \$25K. For new traders, for the first few properties purchased,

an Inland Revenue GST audit of each transaction will be automatic. For established traders, they will still be targeted, but more randomly than new entrants. I consider it is essential to employ a property specialist accountant for accounting advice, GST and tax matters. This person will be the contact point for the IRD, and will resolve issues for these audits, which can be problematic and worrying for the lay person. Generally the trader handling matters directly, will likely cause extensive delays in receiving the approved GST refund. The GST component of any renovation costs, will be claimed along the way, and when the sale takes place, 1/9th of this gross sale price, will become due as GST to the IRD. The result is that although it is great to recover 1/9th of the purchase cost on purchase, it is not pleasant having to find 1/9th of the higher sale price. Properties will have their 'fair market value' in any market, and generally this value will have to include GST. Therefore for the trader selling to a Mum and Dad purchaser, this GST will have to be provided as a 'cost' to the trader, and will need to be paid for out of profits. Whatever the difference is between the net (after GST refund) original cost of the property, plus the net (after of GST refund) of the renovation costs, subtracted from the net (after GST has been paid) selling price, which represents the net profit of the trade (after allowing for GST) has to be assessed for income tax. But this trust income tax is calculated only **after** the distributions have been made, outlined in the earlier "the best business structure" paragraph above.

This example may illustrate these points:

	<u>GST Inclusive</u>	<u>GST</u>	<u>GST Exclusive</u>
Purchase	\$225K	\$ 25K	\$200K
Renovations	18K	2K	16k
Sale	<u>270K</u>	<u>30K</u>	<u>240k</u>
Net GST to pay		3K	
Net Profit			24K

Conclusion

Property trading is potentially very rewarding. One must first ensure that you have the essentials in place to be successful. These essentials will include:

- sufficient property knowledge and confidence,
- sufficient funds as deposits
- Sufficient income to support the borrowing,
- know the market and get the timing right,
- have the best structure to conduct the business,
- engage a mortgage broker experienced in investment and trading strategies, and
- employ professionals experienced in property structuring, accountancy tax GST and conveyancing, to assist you.

However you can get all the knowledge, have your team of experienced advisors, and be in the right mind space, but you still must get out there, make lots of offers and make it happen.

Disclaimer: This information is educational material only and should not be relied upon exclusively. The reader is directed to seek professional advice before proceeding. It is essential to seek specific professional advice pertinent to the individual's requirements as circumstances and conditions may vary.

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