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Specialist Taxation Advisory

### Tax Etcetera

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#### Taxation Review Authority Decision No.1/ 2010

- *When does lending money become a business?*
- *Must IRD allow a past year missed claim?*

The first TRA case for 2010 proved to be a very interesting and important case about whether IRD could disallow bad debt claims of a family trust and, if not, whether it must allow a late claim.

Now TRA cases are not meant to identify the parties but a few minutes on Google and the Companies Office website allowed me to identify the names of the players in this case. I did so as you often get a better feel for the case if you can identify the people and business types involved. So I can tell you that this case is based on a family trust administered by Uwe, an Auckland accountant who allowed the client trust to lend \$100,000 to a Keri Keri daffodil growing company directed by John. Uwe told the court that he relied on representations from Stuart, the director of the farm company that leased the land to John for daffodil growing and then arranged a GSA over the borrower. The loan was for six months but attracted interest of \$25,000 (a 50% interest rate!)

The borrower defaulted. In fact the trustee lenders called the company "crooks" that had absconded with the money. But this is where it gets a bit interesting as my research shows that Stuart was the sole shareholder of both the farm company that the trust relied on to "legitimise" the loan and the daffodil growing company that is now been called a crook. Not the best due diligence eh!

In the meantime the trust had lent to two other parties: a one month \$100K loan netting a \$3K gain, and a two month loan that was supposed to have netted \$10K but was refinanced a couple of times and ended up being a \$48K bad debt! Given these disastrous business (or is that investment?) decisions, the trust stopped lending money.

Now Uwe claimed the \$100,000 bad debt in 20023 but, due to an oversight, did not claim the \$48K. Enter IRD who in 2008 disallowed the \$100K bad debt deduction on the grounds that the trust was not in business as a lender.

Judge Barber disagreed. He said: "*The present disputants were clearly intent on commencing a money-lending business as distinct from passively investing money...many businesses only operate for such short periods ...a small business is a business ...events can lead to it not quite getting started, or coming to an early close ...the disputant trustees carefully vetted all loan applications as best they could ... (not sure about that one Judge), and most importantly ...When I stand back and absorb the above factors, I conclude that there is just, and only just, a sufficient level of activity to support the trustees' intention of profit so as to constitute the business of lending money at material times.*"

So, If IRD has to allow the \$100K bad debt, what about the \$48 loss that was overlooked? IRD reminded the court that the CIR had the power to allow a late claim but that the TRA had no direct power to force him to reopen where there was not a live dispute. Judge Barber dealt with that matter by saying that "*It is possible for the Commissioner to overcome this problem and I invite him to do so*". Coming from the only judge currently determining TRA disputes this sort of an invitation is one that IRD would not want to refuse.

So the first TRA case of the year goes in favour of the taxpayer. Will this trend repeat itself in the next two cases now out? Well, yes and, quite spectacularly, no. Watch this space.

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