

Summary of “Mass-marketed tax schemes”

The term “mass-marketed schemes” refers to schemes in which investors receive more tax losses than the amount of money they have invested. These tax savings occur regardless of the success of the scheme. The schemes cover a range of projects, from films to forestry and the commercialisation of “concepts”.

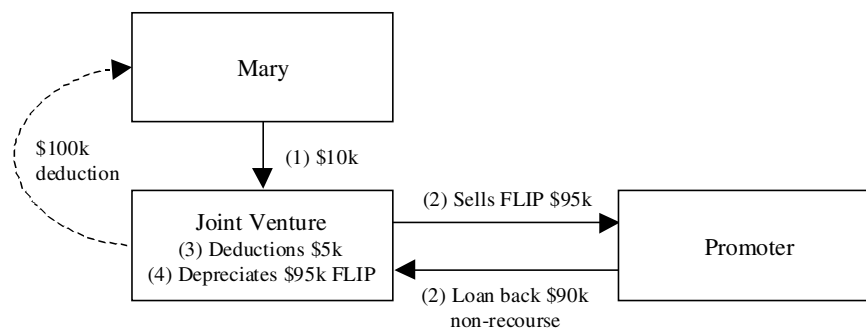
Example

Mary puts \$10,000 into a joint venture (JV) that forecasts losses of \$100,000 over the first three years. It forecasts income of \$150,000 in year four, which in fact does not arise.

The promoter of the scheme sells fixed life intangible property to the JV for \$95,000. This is depreciable over three years. The JV pays \$5,000 cash (from Mary’s investment) for the property, with the balance of \$90,000 funded by a non-recourse loan from the promoter. The JV spends the remaining \$5,000 in a fashion that causes it to be deductible.

Mary receives tax deductions of \$100,000 over three years, saving her \$39,000 if the 39% marginal tax rate applies. This is \$29,000 more than she has or will invest. She has made a substantial gain even though the JV has been unsuccessful.

The cash flows and loss transfers are as follows:



Although tax schemes that exploit loopholes in the tax legislation are not new, there is concern about their current proliferation and their wide-ranging consequences.

The consequences include:

- a loss of revenue to the Government;
- an inefficient use of Inland Revenue’s resources; and
- in terms of the individual investors in these schemes, unexpected exposure to interest and penalties on any resulting unpaid tax.

The revenue at risk to date in the schemes that Inland Revenue is currently aware of is \$436 million. This is significant, and could continue to increase in the absence of a targeted response. However, so far \$100m of this has been recovered by audit activity, which is continuing.

Ideally, investment in these schemes should be stopped, not only to protect the revenue but also to protect investors who unwittingly find themselves under investigation by Inland Revenue. Although investment in such schemes cannot be stopped completely, the combination of carefully targeted legislation, investor education and a range of operational initiatives, will go some way towards this goal.

Officials' suggested legislative response covers two core areas:

- a deferral of tax deductions until matching income is earned, to the extent that tax deductions claimed exceed the amount the investor actually puts at risk; and
- registration with Inland Revenue of certain schemes and notification of registration to investors.

To assist consultation on the complex technical issues involved, officials have been instructed to produce an issues paper on the suggested solution. Inviting submissions is particularly necessary given that any legislative response needs to be carefully targeted so suggested solutions do not affect unintended schemes. Thus the criteria suggested in the paper are not final and will be developed further in light of the submissions received.

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