

September 2015

## Many dreams come true...

And some have silver linings. I live for my dream and a pocketful of gold... many many men cannot see the open road". More Robert Plant lyrics (Over the Hills and Far Away – 1973).

I write this in the context of continued undisturbed foreign investment into NZ assets, yes the Auckland housing market but also other significant land assets, notably farms. To me, policies here are short sighted... but maybe it is I who cannot see the open road?

I hope you enjoy the newsletter items that follow. Each stem from "live" examples that have hit my desk recently.

And of course there is the RWC to look forward to. The AB's pool games are Argentina (21 September), Namibia (25 September), Georgia (3 October) and Tonga (10 October). Read on...

## Restraints of Trade...

These are of course often sought and usually given on a business sale. So, what happens when it becomes time to enforce it?

The first step is to ascertain who in fact is bound by the restraint. If it is limited to the vendor of the business, then the purchaser will have erred. That leaves the vendor free to compete via its associates. So a purchaser should take steps to ensure that the restraint is binding on a wider group than solely the vendor. This is often achieved by way of a deed of covenant and common language used is:

"Neither the Vendor nor the Covenantor shall and shall procure that no employee, officer or consultant of any Associate of the Vendor or the Covenantor will, except with the prior written consent of the Purchaser, whether on his or its own account or as a consultant to or a partner, agent, employee, shareholder, member or officer of any other person, or in any other way... [compete]."

It will be evident from this language that you need to take care to ensure the restraint operates broadly.

## Issue 16

### What's inside

- Restraints of Trade
- Takeovers Code – New Small Code Company Exemption
- GST on Cross Border Services and Intangibles
- Limited Partnerships: Loss Limitation Rule
- Directors Identification Requirements
- NZ Investment into Australia - Structuring

### Briefly - sport

- All Blacks win World Cup: so long as they remain injury free!
- Tiger Woods now outside top 250 in world, topsy-turvy at the top between Rory McIlroy and Jordan Spieth, and now Jason Day.
- Michael Clarke retires, is remembered best for telling Jimmy Anderson he would have his arm broken (oh and also his fallout with Ricky Ponting... and Shane Watson... and Mickey Arthur... but he could bat).

### Briefly – Law/Special Interest

- Graham Brazier has passed away aged 63.
- Danny Lee is locked in a battle for selection in the Presidents Cup golf side to take on USA in October.
- Mark Lacy and Jason Maywald pleaded guilty in face of prosecution by FMA in OPI Pacific Finance case.
- Did you know you can use the camera function on your Iphone to enlarge; useful if you don't have your reading glasses.
- Pink Floyd has officially broken up.
- John Paul Jones (Led Zeppelin) joins Foo Fighters with Queen's drummer to form "superdupergroup".
- Rod Petricevic (Bridgecorp) released on parole despite challenge.



For how long might the restraint be enforceable? There is no scientific answer to this. It all depends on context. In some cases it might only be enforceable for 3 months. In other cases, where for example, a considerable amount is paid for the business, three years might be appropriate.

Next is the territorial scope of the restraint. Extending it to New Zealand is common. Purchasers are however encouraged to limit its scope to the actual area in which they intend to operate and for which they seek protection. That will reduce the risk of a Court taking an adverse view of the territorial scope.

### **Takeovers Code – New Small Code Company Exemption...**

It is a fundamental rule that a shareholder in a code company may not operate in the "no fly zone". This is a shareholding between 20% and 50%. Shareholders in this "no fly zone" have, until now, only been permitted to increase their shareholding under one of the exceptions, requiring shareholder approval or a partial or full offer.

This restriction has now been softened in the case of a small code company (one that is unlisted, with \$20m or less in total assets). The idea is to reduce capital raising costs for small companies.

The "softening" is in the form of an exemption to permit a code company to issue new shares to an existing shareholder where shareholder approval would otherwise be required. The exemption will permit a shareholder, without the need for shareholder approval or a takeover offer, to increase their stake in the company from below the 20% significant holding threshold to say 25%.

This is in the context of a company wishing to raise capital, hence it is first a requirement that the Board has resolved to opt out of the Takeovers Code and that it is in the best interests of the company to do so.

Please contact me for more details.

### **GST on Cross Border Services and Intangibles...**

Hype has centred for some time now on the ability to shop online to purchase goods or services from an overseas supplier without incurring GST and obtaining cheaper prices than are available locally. Of course local suppliers have long been disgruntled by this

practice as the additional GST cost they suffer places them at a disadvantage.

The subject of cross border supplies, particularly in the context of intangibles (eg downloading DVDs) has been, and remains, under close international scrutiny from the tax collection agencies. Meanwhile New Zealand has taken the lead in issuing proposals to deal with the issue.

These proposals broadly require the overseas supplier to charge GST on supplies made to New Zealand consumers. This is consistent with the idea that GST be imposed at the level of the consumer; where the consumer is in New Zealand, the GST liability is to reside in New Zealand.

Supplies to New Zealand businesses are to be exempted. Proxies will operate to assist the overseas supplier to identify whether the consumer is a business. It will be an offence for a non-business New Zealand consumer to knowingly and wrongly assert it is a business. The offence will carry up to a \$50,000 fine.

The obligation on the supplier to charge GST is to be subject to a monetary threshold, likely \$60,000 per annum. Where the threshold is reached, the supplier will be required to register in New Zealand in the usual way. In some cases, for example, apps sold by a local mobile app distributor, the obligation to charge GST will be shifted to the New Zealand distributor. As always in the tax world, the devil is in the detail.

For more information please contact me.

### **Limited Partnerships: Loss Limitation Rule...**

I am often asked about the ability to flow losses through a limited partnership (LP). The short answer is yes losses can flow through a LP. They are, however, subject to a loss limitation rule that limits a partner's access to losses of the LP.

Under this loss limitation rule, a partner may only access those losses up to the extent of the partner's economic interest in the LP (their partners basis). Essentially this is their capital contribution plus share of undistributed profits (reduced by prior year distributions).

Partners should have regard to this loss limitation rule when deciding how to fund the LP. Partners have a choice to do so by way of loan or equity. Where it can

be expected that the LP will incur early year losses there may be advantage in partners contributing funds to the LP as equity rather than as loans. By doing so, partners will avoid limitations on loss utilisation that would otherwise exist. An easy trap to fall into.

## Directors Identification Requirements...

Since 1 May non-resident directors of New Zealand companies have been required to meet stringent identification requirements, including production of a copy of their passport and proof of their address, in both cases notarised. Existing New Zealand companies as at 1 May have until 28 October to comply vis a vis non-New Zealand directors.

Production of these details can be sensitive as regards identity theft. In this context foreign directors may choose to resign and accept substitution of a New Zealand director. (I can put you in contact with an agency here who provide directorial services to such companies). Note also that the requirements do not apply to overseas incorporated companies that operate as a branch here.

## New Zealand Investment into Australia – Structuring...

**Goal:** Avoid double taxation arising from taxation on the basis of residence (in New Zealand) and on the basis of source (in Australia).

### Use of Limited Partnerships

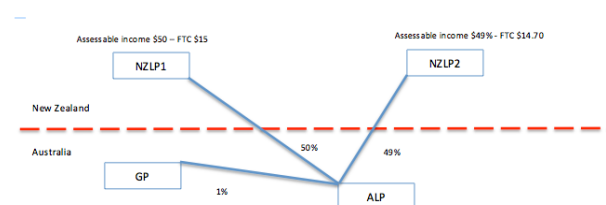
Under Australian tax law, Australian limited partnerships (ALP) formed in Australia are corporate limited partnerships and are treated as a company for tax purposes (but are not companies for corporate law purposes). New Zealand, on the other hand, treats limited partnerships (including those established in Australia so long as they are not "foreign corporate limited partnerships", ie corporate entities under corporate laws as look through vehicles).

The consequence is that in Australia it is the ALP that is taxed, whereas in New Zealand the limited partners are taxed. There is a mismatch here that would cause a tax problem (double taxation) but for relief under the Australia/New Zealand double tax treaty (DTA).

That relief means that investment in an ALP will be tax efficient so long as the income derived by the ALP gives rise to tax paid in Australia (and not elsewhere)

and the tax is paid by the ALP itself (and the tax is not represented by imputation credits attached to a dividend, for example). If these criteria are not met, the DTA will not afford relief because the taxes in question will fall outside its scope.

### Example: Australia Source Income



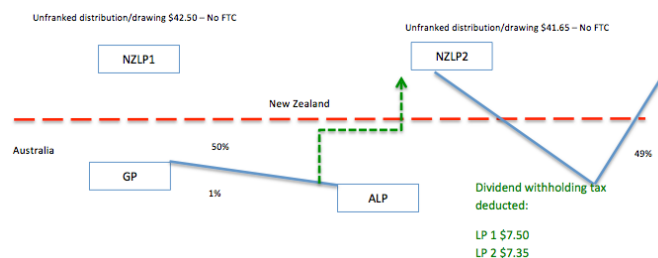
ALP earns trading income in Australia of \$100 and pays Australian company tax of \$30 on it.

The trading income is partnership income to the partners, so they must include their partnership share in their taxable income. The Australian company tax is allowed as a foreign tax credit (FTC) in the same proportion as the partner's partnership share.

So:

NZLP1 has assessable income of \$50 and a foreign tax credit of \$15 and the 49% partner – NZLP2 has assessable income of \$49 and a FTC of \$14.70.

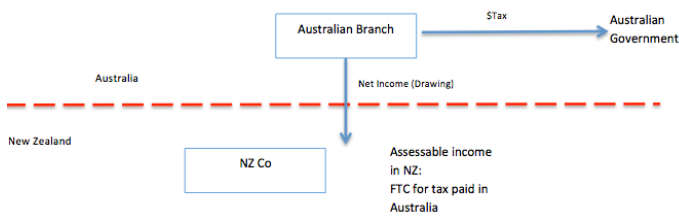
### Example 2: Distribution made by ALP



The ALP makes an unfranked distribution to the partners of \$100. For Australian income tax purposes, this is treated as a dividend and NRWT of 15% is deducted (leaving a net distribution of \$85). While the NRWT has been paid, it has not been paid in respect of NZ assessable income because in NZ the net \$85 has the character of drawings and is not subject to NZ income tax. Therefore no FTC is available here.

Thus the ALP structure works efficiently only where distributions by the ALP are franked/imputed.

## Operating through a branch of a NZ Company

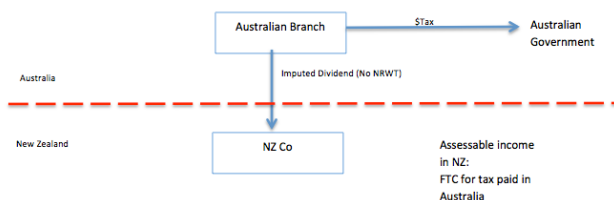


**NB:** FTC not available for benefit of shareholders meaning that NZ shareholders will ultimately receive amounts from trading in Australia that have both Australian and NZ tax taken from it.

### Conclusion

Depending on circumstances of NZ shareholders, use of a branch is less tax efficient than LP structure.

## Operating through a Subsidiary in Australia



### Conclusion

Use of a foreign subsidiary is the least tax efficient structure at the level of the NZ Company. It becomes equally as tax efficient as a branch structure when distribution to NZ shareholders is added to the picture, because NZ shareholders will ultimately receive amounts from trading in Australia that have both Australian and NZ tax taken from it.

## CFC Rules (of the Tax Act)

There is a blanket exemption from the CFC rules (ie the attributing income rules around interests in overseas companies) for Australian companies. The exemption operates irrespective of the recently introduced active/passive business test. The exemption does however require the foreign company (CFC) to meet the following tests.

- The CFC is resident in Australia and subject to income tax in Australia; and
- The CFC remains tax resident in Australia after applying a DTA;
- The CFC's tax liability has not been reduced by an exemption from income tax for income

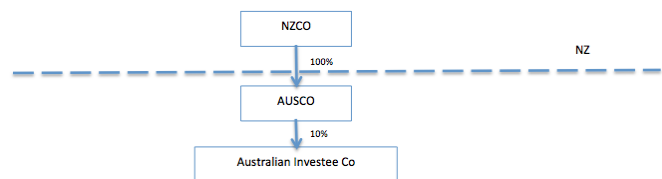
derived from business activities carried on outside Australia/an offshore banking unit or relief; and

- The CFC is not a unit trust.

If it fails any of these tests non-attributing exemption will not apply. Instead, NZ investors will be liable to pay NZ income tax on their proportionate share of the CFC's attributed income (with an allowance for any foreign tax paid on that income), calculated generally under the branch equivalent method.

Note that this exemption does not extend to FIF (portfolio) interests held by the Australian CFC.

### Example:



In this example, NZCO will be subject to tax on its investment in the Australian Investee Co under the portfolio FIF rules.



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