SPEAKMAN LAW

December 2015

Issue 17

What's inside

- Health & Safety Laws
- Tax Penalties
- LTCs – Proposed Changes
- Residential Land Withholding Tax
- Takeovers Code (small code companies)
- Employee Share Purchase Schemes

Briefly - sport

- Tiger Woods finishes year outside top 400
- McCaw's 148 test match appearances a world record
- Kane Williamson now has 13 test centuries, equal with Ross Taylor and behind only Martin Crowe (17)
- Jordan Spieth finishes year no. 1 golfer

Briefly – Law/Special Interest

- Competition Law (Commerce Act) up for review
- Corporate governance guidelines for listed companies issued
- New incorporated societies legislation on its way
- Mergers and acquisitions activity strong, forecasts for 2016 to be high, driven by offshore interest

Down by the Seaside…

Down by the seaside. See the boats go salin! Down in the streets, see all the folk go racin', racin'. No time left, to pass the time of day. The people turned away.

Led Zeppelin lyrics from Physical Graffiti's "Down by the Seaside". Appropriate with the holiday season upon us.

Many thanks to all of you for your continued support this year and may the festive season deliver all your wishes.

Below are topical issues for your consideration in 2016. Take Care

Health & Safety Laws…

April 1 marks the commencement date for the new health and safety laws. Directors will of course need to be aware of and ready for them. They are the ones who primarily bear responsibility regardless of their involvement in the day to day operations.

Others will also be liable. Any person who comes within the meaning of an "officer" will also be liable. That term is deliberately targeted at those persons who are best able to identify, monitor and protect against risk events for employees. The term officer is defined to include any person who's role allows them to exercise significant influence over the management of the business. The CEO is certainly within this scope. So would be a regional manager, though probably not a product or sales manager.

Companies should take steps to identify who within their organisation may be liable as from 1 April 2016 and begin, if not already commenced, an education process for them.

Tax Penalties…

Penalties in the tax arena are generally of two types, namely behavioural penalties and penalties for late payment or failing to file a return. This article addresses penalties for behaviours that do not cross the threshold of criminal behaviour. These penalties are referred to as shortfall penalties and vary in size according to culpability. The range of penalties is as follows:

Penalty type	Applicable Percentage	Circumstances
Not taking reasonable care	20%	Applied when taxpayer files a tax return without having taken reasonable care over a position in it
Unacceptable tax position	20%	Applies when taxpayer has taken a tax position that fails the test of being as likely as not as being correct
Gross Carelessness	40%	A more culpable stance of the taxpayer is required here; the taxpayer must have taken a tax position having shown a complete or high disregard for the consequences
Abusive tax position	100%	Essentially this penalty applies where the taxpayer has entered into a tax avoidance arrangement
Evasion	150%	Entails behaviour that seeks to evade the assessment or payment of tax

Of some interest is which of these is most commonly applied. Also of interest is a clear trend towards penalties for evasion. In the year ended 31 March 2014 evasion was the most commonly charged of all penalty types. Equally interesting is an upward trend in the incidence of penalties for gross carelessness.

Essentially this signals that Inland Revenue is becoming increasingly vigilant in imposing more severe penalties. In the year ended 31 March 2014 by far the most penalties were imposed for abusive tax positions with penalties totalling $34.8m. In the year ended 31 March 2011 commensurate type penalties were $12.7m hence there has been a threefold increase.

Noteworthy also is the incidence of penalties relating to GST. By far the greatest volume of penalties is imposed in relation to GST which is indicative of heavy IRD resourcing of property transactions.

Please contact me for more details.

LTCs – Proposed Changes…

Changes are proposed to the look through company rules to remove obstacles to using them while tightening rules around trust ownership.

The major obstacle to be removed is the loss limitation rule. Broadly this has served to limit the pass through of losses to the owner's capital in the company. This rule has proved unduly complicated in practice and has discouraged many from adopting a LTC where they otherwise would.

Removal of the loss limitation rule for LTCs is both welcomed and warranted. It will greatly simplify the LTC regime and will ensure the regime more closely resembles persons who carry on business in their own name personally.

The goal of making LTCs more user friendly however in many instances will be defeated by proposed changes to rules around trust ownership. Where trust ownership is required (as is often the case) those changes are likely to disenchant many from using LTCs and may outweigh the benefits that will flow from doing away with the loss limitation rule and other simplification measures.

The changes in this area will extend to six years (doubling the existing period) during which beneficiaries who receive distribution from trusts can be counted as look-through owners. Where a distribution is made by a trust to a beneficiary, the beneficiary is treated as an owner. If distributions are made to more than 5 persons then the company will cease to qualify as an LTC. The test for applying these distributions is now 6 years. That will require careful management and will put an onus on directors of the LTC and trustees of the trust alike to manage distributions in such a way that the maximum 5 person owner eligibility test is not breached. For directors and trustees to live under the shadow for a 6 year period is a big ask. In this regard the use of limited partnership (LPs) remains a viable alternative. They permit ordinary limited companies as "owners" (whether via a trust or directly) and permit distributions to a wide number of people. A result of the proposed changes may well be to create a preference for LPs, thereby having the opposite effect to that intended.

For more information please contact me.

Residential Land Withholding Tax…

Announcements earlier this year to introduce new tax rules targeting short term residential sales by overseas persons foreshadowed additional rules introducing a withholding tax . A Bill containing those rules has now been tabled before Parliament. The obligation to withhold tax will apply to overseas persons selling residential property that has been acquired on or after 1 October 2015 where the property is sold within 2 years.

Exemptions will exist where the property is the seller's main house. That exemption is perhaps likely to be of limited application in the context of an overseas person being the seller. Exemptions will also exist for inherited property and relationship property.

Application of the withholding tax is limited to an "offshore person". For the most part this will be self evident. However it also includes a New Zealand citizen who is living overseas if they have been overseas for the last 3 years.

The amount of withholding tax is to be the lesser of the tax rate (33% or 28% as applicable) applied to the gain and 10% of the current purchase price.

The withholding tax is not intended to be a final tax. Then it is open to the seller to claim any available deductions in its tax returns; those deductions may result in a tax refund or credit becoming available.

Where a sale is effected through an agent, the obligation to withhold the tax will fall on the agent. Though the agent is not primarily liable for it, in practice this is unlikely to be of significance.

Takeovers Code (Small Code Companies)…

Companies with assets below $20m will generally meet the definition of a small code company under the Takeovers Code (**Code**). This will place them at an advantage in raising capital from existing shareholders. This is courtesy of an exemption notice that is applicable from 14 July 2015.

Rule 6(1) of the Code will not apply where the criteria for the exemption notice are satisfied. Rule 6 is the fundamental rule which prohibits shareholding increases above 20% of a Code Company's voting rights, except for increases made under the Code's rules (ie by way of a full or partial offer) subject to a couple of exceptions, notably the ability to "creep" by 5% each year for shareholders holding over 50% of the Company's shares.

The fundamental rule is a barrier to companies wishing to raise further capital from its existing shareholders. The exemption for small code companies recognises this is neither desirable nor appropriate for small companies.

A small code company may freely (ie without restriction under the Code) issue shares to its shareholders where:

a. the board has resolved to opt out of the Code and that it is in the best interests of the Company to do so;

b. within 28 days of passing that resolution, the Company has sent to each shareholder and to the Takeovers Panel a disclosure document (see below);

c. the Company has not, within the objection period stipulated in the disclosure statement, received written notices objecting to the opt out from the Code from holders of 15% or more of the free float (the percentage of voting rights in the Company that are not held or controlled by an exempt allottee or its associates);

d. the relevant allotment is made after the end of the objection period but within 90 days of the board's resolution to opt out of the Code;

e. prior to the allotment there has been no change in the Board's position and the shareholder allottee has not otherwise increased its shareholding in the Company in the interim.

The disclosure document must contain the prescribed information set out in paragraph 6 of the Exemption Notice. Amongst other things this requires a brief description of the allotment. The other requirements are straight forward.

The exemption notice provides welcome relief for small companies that are, in some cases inadvertently, caught by the Code.

For more information please feel free to contact me.

Employee Share Purchase Schemes…

Inland Revenue has issued a Revenue Alert that is of considerable concern to many standard employee share schemes. The Revenue Alert states Inland Revenue's view that many employee share schemes amount to tax avoidance.

The schemes in question are those that entail use of an employee share trust. Shares are issued or transferred to the trust and held by the trustees for the benefit of employees. Schemes of this type vary widely. At their heart, however, is the idea that shares are "acquired" by the employees at the time the shares are received in trust for them and prior to the time the shares transfer outright to the employee. Often the shares are retained in trust for the employee for some years, referred to as a restrictive period. The intended tax result, and indeed the one that is specifically legislated for, is no tax on the uplift in the value of the shares during this restrictive period.

As mentioned above, schemes of this type vary. In some cases, the employee will have the right to dividends on the shares during the restrictive period, or to other rights (bonus entitlements for example). Voting rights are usually the preserve of the trustee during this time.

Like any shares, there is the risk that they fall in value. If that risk is passed onto the employees, and the risk eventuates, employees are likely to become demoralised by their entry into the scheme rather than incentivised by it. Consequently many schemes introduce protection to shelter employees against this risk. Where that protection is afforded to the employees, economically their position is akin to an option.

Here is the rub. Employee options are taxed differently; there is no tax exemption on the exercise spread (uplift in value) during the option exercise period. Inland Revenue consider that some employee trust schemes are an economic equivalent to options and should be taxed as such. Worse, it is their view that these trust schemes amount to tax avoidance where they seek to deliver an economic equivalent to options while avoiding tax on uplift in value of the shares during the restrictive period.

This leaves advisors in a quandary. Employee share schemes are commercially based, not tax based. How then might advisors achieve the desired commercial outcome without risk of a major tax wrangle?

Inland Revenue cite the following factors when deciding whether to investigate a case:

- the level of control the employee has over the shares while they are part of the share purchase agreement;
- whether during any restrictive covenant period the employee can exercise rights attaching to the shares (such as voting rights) and whether the benefit of dividends, if any, is passed to the employee in commercial and economic reality;
- whether the nature of the arrangements put in place means that benefits attaching to the shares during the restrictive period are enjoyed more by the employer (or trustee) than the employee;
- whether the employee has any direct or indirect rights to dispose of the shares in a way that negates the original acquisition or otherwise means the employee is not exposed to real commercial risk on ownership of the shares;
- whether as a matter of commercial and economic reality, the arrangement is more likely to be categorised as an option rather than a full acquisition of the shares.

It will certainly be possible to design an employee share scheme involving, an employee share trust and retention of shares by the trustee for a restrictive period without the threat of a tax avoidance challenge. Such a scheme might contain no features that protect the employee from any downside risk and confer dividend and voting rights on the employee. Where, on the other hand a scheme departs from these terms, a tax avoidance challenge emerges. It is all a question of degree but clearly great care is needed in establishing these schemes.

Please contact me for more details.

Christmas Break…

Speakman Law's Offices will be closed from 24th December 2015 and opening 18th January 2016.

We wish you a very safe and Happy Holiday

Our Website…

Read our newsletters online at www.speakmanlaw.co.nz.

Come visit…

Please feel free to pop in for a visit at Suite B, Level 1, 7 Windsor Street, Parnell.

Contact details

Peter Speakman
Principal
T: +64 9 973 0577
M: 021 854 642
www.speakmanlaw.co.nz