SPEAKMAN LAW

December 2019 – Commercial and Tax Edition

Issue 34

What's inside

- Reactions to New Trusts Act.
- Habitual Buying and Selling of Land.
- Zero rating on land sales.
- Investment in start up companies.

Briefly – Special Interest/Law

- Eric Watson's Cullen Group loses case to stay $500,000 costs award in its tax avoidance case; now being pursued for more than $200m.
- Claim underway against directors of failed insurer CBL.
- Bankruptcy proceedings continue against Richard Yan (Mainzeal director against whom the court awarded damages of $18m).
- Massive tax changes for multinationals signalled internationally as global tax shake down continues.
- Timothy Spall in Auckland supporting latest film about UK artist LS Lowry. Very nice chap.

Briefly – Sport

- Black Caps win over England in first test a welcome panacea for 2019 sporting ills.
- New All Black coach likely to inherit a poisoned chalice; ABs have years of rebuild ahead of them, in my view.
- Forthcoming Black Caps Boxing Day test in Melbourne, a timely return given this team's comparability in strength with the 1987 team that last played there.
- Presidents Cup to get underway next week, missing Phil Mickelson for the first time in over 25 years.

Welcome to our final newsletter for 2019. In between distractions of school prize givings, end of year work functions and vexatious litigation (timed to create maximum impact), I trust you find the articles below of interest. Each of them is highly topical. With that, I thank you all for your support again this year and wish you a wonderful Christmas and holiday season!

Reactions to New Trusts Act…

The predominant response I observe to the new Trusts Act is one of alarm. There appears to be a mix of incredulation and concern at the requirement to write to beneficiaries.

In a family setting this is particularly pronounced. In that context there is the sensitivity around parents providing their children with fulsome information about the trust and potential responses from the children, ranging from malaise to agitation.

This begs two questions:

a. how strict is the requirement that trustees write to beneficiaries about the trust, and what information is to be provided to them? and

b. might the trust just be wound up?

Dealing with the first question, the new Trusts Act entails a balancing act. It establishes a presumption that trustees will provide basic trust information to beneficiaries, coupled with more extensive information (for example, financial statements) on request. It is only a presumption, however. Trustees must balance a host of factors specifically set out in the Act, notably the settlor's intention that a particular beneficiary receive trust information and the effect of providing the information on family dealings.

Where the trustees consider it wrong to provide information to the beneficiaries, having had regard to these factors, they are entitled to withhold it. But it is not as simple as this.

The framework of the new Trusts Act is a presumption that trustees provide information to beneficiaries, unless there is good reason not to.

Trustees will stand to be challenged should they suppose there is good reason to withhold information. Foreseeably, trustees might find it difficult to overcome such a challenge if they have chosen not to provide any information, even basic information as to the existence of the trust and who the trustees are.

How might trustees establish good reason to withhold all and every bit of information about the trust?

Many trustees may choose to take the easy way out and provide trust information holus bolus to any beneficiary who requests it.

Is there a better way? Yes there is. One solution is to narrow the classes of beneficiaries to those who it can be expected are truly to benefit from the trust. This would generally include immediate family members, and entail removing less immediate family members from the list of discretionary beneficiaries.

Most trust deeds that I have seen expressly permit this. In other cases it may be necessary to invoke a power to vary the deed, assuming the trust deed contains power to do so.

Another, potentially better, solution is for the settlor to establish priority amongst the beneficiaries. Close family members might be categorised as Primary Beneficiaries and others as Secondary Beneficiaries, for example. This avenue is only available for newly established trusts and where the settlor's order of priority can be asked of him or her.

For such newly established trusts it would be advisable to insert into the trust deed a direct statement of the settlor's intention along the lines that the trustees are to provide trust information to the Primary Beneficiaries. That statement might add that trustees are only to provide trust information to Secondary Beneficiaries where the trustees have considered the interests of the Primary Beneficiaries and resolved not to provide trust information to them.

Turning to the second question, a natural response to the potentially awkward position that trustees may find themselves in is to re-visit the continuing need for the trust.

Many historic reasons for a trust are now long gone. Protection against estate duty is no longer relevant, tax advantages are not what they once were and their usefulness in means testing for residential care grants is heavily impacted by clawback rules. Protection from creditors remains a valid reason for trusts, but is relevant to only a few.

That leaves general wealth and maintenance provisioning by a settlor in favour of chosen beneficiaries as the most common remaining reasons for a trust. It will be far more purposeful to some rather than others.

My suggested response to the new Trust Act is first to consider the continued need for the Trust and, if there is one, to limit or alter the classes of beneficiaries in the way described above.

A final word on the subject of trusts is that the new Trusts Act applies equally to charitable trusts. Trustees of charitable trusts therefore face the same dilemma as regards providing information to beneficiaries as face trustees of private trusts. That will require great care. One difference is that the maximum duration of 125 years for a trust, specified in the new Trusts Act does not apply to a charitable trust. Instead such trusts can continue indefinitely.

Habitual Buying & Selling of Land

Inland Revenue continues to focus on taxation of land activities. Earlier this year, ring fencing of losses from residential investment properties was introduced. Inland Revenue have now turned their attention to the exclusion from tax for people who use land as their main home, residence or business premises.

These exclusions do not apply where there has been a regular pattern of buying and selling property used for such purposes.

Taxpayers often find it achievable to work around these exclusions. They can do so by avoiding a "pattern" of land sales. There is no pattern where the land activities are in the names of different, but associated, persons each time. Similarly, there is no pattern where no similarity or likeness between the land transactions exists. There is no similarity or

likeness, for example, where one person bought bare land then built a home on it, and in the case of another property, that person simply lived in a pre-existing home until the time of sale.

These rules are likely to change. A Bill is forecast for early next year that will amend the applicable provisions here. The Bill will extend a pattern to persons, or groups of persons, or entities to land that has been occupied by the person or group as their main home, residence or business premises or occupied as a main home, residence or business premises by the person or group of people that control the entity or entities that own the land. The Bill will also remove the regular pattern restrictions where a person has a pattern of buying and selling land that they occupy as a residence or business premises, where they carry out different activities on the land while they hold it.

Expect these law changes to come into force from 1 April 2020, though there is some prospect of them applying retrospectively.

Zero Rating on Land Sales Misunderstood

The compulsory zero rating (**CZR**) rules continue to be misunderstood. Take the example of a GST registered vendor who sells to an unregistered purchaser at a purchase price that is "inclusive of GST".

CZR is not available on such sales. Consequently, the vendor is required to account to Inland Revenue for the GST component of the purchase price. It can be expected that the vendor will have priced the property accordingly.

In practice, what I often see is representation by the purchaser that it is GST registered, or will be as at settlement perhaps in contemplation of nomination in favour of a third party buyer. In reliance upon such representation, the sale is zero rated for GST purposes and GST does not enter the equation.

The purchaser's representation as to its GST status is critically important to this outcome. If it is incorrect, that mistake is legislatively corrected by little known section 5(23) of the GST Act which imposes the GST liability on the purchaser.

Purchasers seem to be caught out here by an apparent belief that, if the vendor was entitled to GST registration in respect of the subject property, then so must the purchaser be so entitled. This however, ignores the circumstances of the vendor's GST registration. Where the vendor had developed the properties, its GST registration will hinge on the development activity. This does not carry over to the purchaser. What is its taxable activity? Where the properties are residential, the purchaser will be unable to establish a taxable activity in respect of them (unless they are to be further developed). It is here where mistakes seem to recur. Purchasers then learn about section 5(23) of the GST Act and the consequence of their mistake.

Investment in Start Up Companies

Commonplace is the need for fresh capital in a start up company. Founders will often have sought to commercially exploit the genesis of an idea or product, funding the early stages of development themselves. To take the idea or product to its next stage the founders require additional capital.

Tax loss continuity rules come into play here. The start up company established by the founders and funded by them to this point will have tax losses to the extent of the funds expended on the idea or product (except to the extent the expenditure is capital in nature). These losses will only be presumed where the newly obtained capital that is much needed to fund the further development does not breach the loss continuity rules. Those rules will be breached where there is a substantial change in identity of shareholders (specifically 49% continuity is required for the company to retain its losses).

These loss continuity rules have long been a problem for start up companies. This problem may soon be removed. Inland Revenue is presently consulting on possible changes to these rules.

One possibility is for the losses to be retained by the company and their use deferred on a cascading basis that overcomes concern in trading tax losses. Another possibility is to transfer the losses to the founders.

Yet another possibility is to ignore shareholding changes and focus on business continuity, as is the case in Australia. Regardless of which of these alternatives is adopted, relaxation in this area is anticipated and will be welcome.

I will keep you posted on developments.

Our Website…

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

Come visit…

Please feel free to pop in for a visit at Level 15, 36 Kitchener Street, Auckland.

Contact details

Peter Speakman

Principal

T: +64 9 973 0577

M: 021 854 642

www.speakmanlaw.co.nz