SPEAKMAN LAW

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What's inside

Economic Outlook

I recently attended a presentation given by a leading economist with one of the trading banks. It was a fascinating presentation, hence I thought I might share the thrust of it with you. Key points, in summary form, are:

- Shipping costs have increased five fold. The primary cause has been reduction in capacity, due to port closures in China, coupled with a surge in demand.
- Inflation has increased to 7.3% from 6.9% in the March 2022 quarter.
- Tradeables inflation is well above 8%, largely attributable to the increase cost of imported product, domestic inflation is lower (about 6%) but twice the RBNZ upper band.
- Inflation rates will remain high for the next four years, and not return to 2% for 10 years.
- Interest rate curves are all pushing up
- Both fixed income and equities indices are falling
- Mortgage rates are rising and are continuing to rise. Consequently, household debt servicing costs have risen and are going to markedly rise further, leading to forced reduction in debt taken on by households
- The unemployment rate, at 3.2% is very low, causing wages to spike
- Business investment is forecast to contract in the second half of 2022, resulting in no growth.
- Net migration flows - high numbers of New Zealanders are leaving; both short term and long term. This will continue to impact labour supply.
- National debt in proportion to GDP is low by international standards, facilitating increased government debt if necessary, but doing so would likely spur domestic inflation and further push up interest rates.
- House prices are expected to fall to match early 2021 price levels. Causes are the spike in interest rates, net negative migration and tightened lending rules which have reduced money supply. They are expected to bounce back in 2023 and into 2024.

And now as the Two Ronnies used to say, Here is the News.

A Private Capital Raising Having Gone Wrong

Offers of financial products to "wholesale investors" escape the costly and demanding need for a product disclosure statement to accompany a regulated offer. Reliance on the wholesale investor exception has commonly been a straightforward matter as those involved in capital raising for SMEs and start-ups will have experienced. In the usual case, an information memorandum is issued with accompanying forms requiring investors to confirm their 'eligible investor' status by having an independent advisor certify that the investor is sufficiently knowledgeable and experienced to understand the merits of the offer and the investor's own information needs relating to the offer.

A recent case involving the Du Val Group illustrates problems that can nonetheless emerge. The problems befalling the Du Val Group are discussed below. They illustrate that regardless of the availability of the wholesale investor exception to an offer of financial products, care is required both with the content of promotional material relating to the offer and the manner in which it is distributed.

The Du Val Group is a large real estate development, investment and asset management group. Through a limited partnership (LP) it had sought $100m to fund the acquisition and development of Du Val projects. These funds were to be raised by way of an issue of redeemable units in the LP. The offer of units in the LP was strictly limited to persons who met the definition of "wholesale investor" in Schedule 1 of the Financial Markets Conduct Act (FMCA).

The Financial Markets Authority (FMA) found fault with the offer and issued a direction order effectively requiring the Du Val Group to put a stop to the offer. Essentially the FMA identified two faults with the offer, firstly that the accompanying promotional material contained misleading representations and secondly, the method of distribution of that material permitted it to fall into the hands of inexperienced investors.

The Du Val Group challenged the FMA's direction order by appeal to the High Court. As to the first cause for complaint , the Du Val Group argued that no misleading representations had been made and moreover no harm might come from any representations that may be found to be misleading. They argued that no harm could arise by virtue of having limited the offer only to wholesale investors, who are inherently equipped with a sophisticated knowledge of investments allowing them not to be misled. As to the second cause for complaint, the Du Val Group asserted that the fact that the offer was advertised widely was irrelevant because only wholesale investors could take up the offer.
The Court rejected Du Val's arguments. The Court did not accept that wholesale investors are inherently sophisticated when it comes to considering investments and pointed to the fact that "large" investors (persons investing upwards of $750k) automatically come within the umbrella of a wholesale investor regardless of how it is they came to be wealthy or any previous experience in investing. In any event, the Court was not persuaded that the fair dealing provisions of the FMCA could be disregarded merely on account of the attributes of the audience.

It is the second part of the Court's ruling that is of most interest and application to the manner in which offers to wholesale investors ought to be made. The Du Val Group had, as one of its means of advertising the offer, included it in a social media platform. By doing so, the offer would inevitably reach not only experienced investors but also investors who were entirely lacking in experience. The Court foresaw instances in which such persons might be attracted to the offer and thence set about attaining the necessary eligibility as wholesale investors without appropriate credence. The inference is that the obligation falls on an offeror who seeks to rely on the wholesale investor exception to ensure that the offer is circulated only to experienced investors. While that may be a path that is already followed by many, for those who seek to advertise their products more widely, the Du Val case is a warning.

Tax Law

Two articles of interest to tax readers follow, the first involving the Brightline test and the second involving the business continuity test.

The Brightline Test

Transfers of land often invoke consideration whether or not the Brightline test is re-started. Inland Revenue has recently issued an Interpretation Statement (IS /22/03) that is most helpful in this regard.
IS 22/03 highlights that there must first be a disposal for the land tax rules to apply. In turn, in order for there to be a disposal:

a) Land must be "got rid of" by the disposer; and
b) One person must lose ownership of the land and another must gain it.

Various instances of co-ownership changes invite the question whether there has been a disposal. These are noted below.

Is there a "disposal" when the form of co-ownership changes, but the proportional shares do not change?

This may occur where, for example, joint tenancy ownership is substituted with a tenancy in common, or vice versa. This will not be a disposal. That is because there is no alienation of the land and at no point do the parties lose control of the property. Also, there is no "dealing with" the land, in the sense that the land does not move from one party to another.

Is there a "disposal" when the parties proportional shares change?

An example might be where co-owners hold the land as 50-50 tenants in common and then move to holding it as 75-25 tenants in common. Notable in this example is that no ownership interest is fully alienated, and it is instead reduced. This will amount to a disposal to the extent of the reduction. The Brightline period will restart with respect to the proportionate interest in the land that has transferred but not with respect to the balance of the land.

Is there a "disposal" when a co-owner is added or removed?

Yes, to the extent of the diluted ownership share.

Is there a "disposal" when land is transferred on a change of trustees of a trust?

No. Tax legislation essentially treats all of the trustees of a trust as a single person. Consequently, a change in title reflecting a change of trustees is merely a disposal to one-self and is disregarded. It does not restart the Brightline period. Note, however, the opposite is the case if land is resettled on a new trust notwithstanding that the resettled trust may have identical trustees to those of the old trust. Resettlement is a taxable event and amongst other things, will restart the Brightline period.

Whilst some of these conclusions are perfectly obvious and are as one would expect, it is nonetheless helpful to have any doubt about them removed.

Continuity of Business Test

The loss carry forward rules were recently eased (actually it was over a year ago now, somehow it doesn't feel that way), by permitting companies to carry forward losses where their business is unchanged, notwithstanding a significant change in shareholding. Prior to this 'easing', a 49% change in shareholding in a company was enough to cause the company to forfeit its tax losses.

This was particularly problematic for start-ups, which invariably are reliant for that growth on multiple capital raising rounds, with each one sometimes cancelling out the benefit of prior tax losses.

The continuity of business test permits a company in respect of which there has been a shareholder continuity breach provided there has been no 'major change' to its business, or if there has been, it is a 'permitted change'.

In determining whether a major change has occurred, a key factor will be the extent to which the assets used in deriving the company's assessable income have remained the same or similar over the relevant period. Obviously, assets of a company may need to be replaced due to wear and tear, obsolescence, or to keep up with new improvements. Provided the replacement assets are of the same character as the assets they are replacing and are similar in size and number, the change in those assets will not represent a major change.

Other relevant factors that are to be taken into account include changes in business processes, suppliers, personnel, scale and the type of product or service offered.

Inland Revenue has issued an Interpretation Statement that is most helpful in determining whether a major change has occurred, and more broadly in applying the business continuity test. Nonetheless, Inland Revenue conclude that this remains a difficult thing to determine and it may be easier to start with identifying where there has been a permitted change. If a change is permitted, then it is no longer necessary to establish whether the change is major. Permitted changes are those

a) Made to increase the efficiency of a business activity that the company carried on immediately before the beginning of the business continuity period;

b) Made to keep up to date with advances in technology relating to a business activity that the company carried on immediately before the beginning of the business continuity period;

c) Caused by an increase in the scale of a business activity that the company carried on immediately before the beginning of the business continuity period, including as a result of the company entering a new market for a product or service that it produced or provided at that time;

d) Caused by a change in the type of products or services the company produces or provides that involves the company starting to produce or provide a product or service using the same, or mainly the same, assets as, or that is otherwise closely connected with, a product or service that the company produced or providing immediately before the beginning of the business continuity period.

As is often the case with tax relieving provisions, the business continuity test comes with its own anti-avoidance rule. This targets arrangements by which:

a) A company pre-emptively changes the nature of its business activities in the 2 years prior to an ownership continuity breach in order to enable the business continuity test to be satisfied after the breach;

b) A company that carries forward losses under the business continuity test derives income that would otherwise have been derived by an associated person; or

c) An associated person of the company that carries forward losses under the business continuity test incurs expenditure or loss that would otherwise have been incurred by the loss company.

Trust Law

Below is discussion of a trust case that, unfortunately is not an isolated saga, followed by an outline of trust packages we offer.

Mason v Triezenberg: What were the Trustees Supposed to do?

This case reflects the rather sad circumstances that sometimes accompany ageing. The case involved a gentleman in his mid 80's, Mr Mason senior. His wife had been diagnosed with dementia requiring full time specialist care and seemingly, Mr Mason senior was in denial about that. At the very least, he was opposed to it for whatever reasons as the facts below apply illustrate.

Mrs Mason's health had deteriorated, first to the point that she required in-home care three days a week on account of early stage dementia and, later resulting in her being certified mentally incapable due to her dementia. In the interim Mrs Mason had appointed her daughter, Ms Triezenberg, as her attorney in respect of property affairs and personal care and welfare. That power of attorney was activated upon Mrs Mason being certified as mentally incapable. Medical advisors recommended to the family that Mrs Mason be admitted to residential care specialising in dementia. Ms Triezenberg, with support of her siblings accepted that advice and so Mrs Mason was duly transferred to St Andrews Village.

The costs of that care were met by a family trust settled by Mr and Mrs Mason. The trustees were Mr Mason senior, Ms Triezenberg and the family's longstanding accountant, Mr Dodd. Mr Mason was vehemently opposed to Mrs Mason being placed in care and was very upset about it. He wanted her to return home. He posted a "mock" death notice for her at the hospital and sent a copy to each of the children. He repeatedly wrote to his daughter, Ms Triezenberg and Mr Dodd, as co-trustees, in an insulting and threatening fashion. He also applied to the Family Court for orders revoking Ms Triezenberg's power of attorney. Subsequently, he refused to authorise invoices issued to the trust for Mrs Mason's care.

His opposition and interference did not end there. He caused such difficulties with the nursing staff that the hospice, through its solicitors, issued a final warning to Mr Mason senior for his aggressive and rude behaviour, which the hospice not long after acted on.

In the result, Mrs Mason was transferred home with 24/7 care to be provided by an external nursing agency with the costs met by the trust. Again, Mr Mason was obstructive, refusing to pay invoices for Mrs Mason's in-home care and even for such things as a haircut for Mrs Mason.

Ms Triezenberg and Mr Dodd, as the other trustees of the trust, formed the view that it was necessary for Mr Mason to be removed as trustee. Their application to the Court to do so, seemed to have sparked Mr Mason seemingly to behave in a more co-operative fashion , allowing costs for care to be met. Ms Triezenberg and Mr Dodd nonetheless pressed on with their application to remove Mr Mason as co-trustee, on account of the level of dysfunction that had developed between the trustees.

The Court approved the application. The Judge acknowledged that trustees should not be lightly removed and that incompatibility between trustees and beneficiaries was not enough to justify removal. Nonetheless, the Judge recognised that the position of administration of the trust was "well past the point of mere incompatibility" and the Judge could not see any prospect of the three trustees being able to work together on a ongoing basis".

It is difficult not to feel sympathetic for Ms Triezenberg. She had accepted the role of trustee no doubt wanting to be helpful to the wider family's best interests, knowing that someone had to do the job. Possibly she felt that of the family members she was most able to do it. Plainly she applied diligence and perseverance to her role as trustee and along the way, copped great abuse from her father and was physically assaulted by her brother at a family meeting.

What was she supposed to do?

Trust Package Offer

Some of you may have trust arrangements in the back of your cupboards that haven't been considered for some time. They are either doing a good job, and meeting their required purpose (but perhaps not as compliant as they could be), or they are past their best and are no longer required. We have been working with many clients to help them with their ageing trust arrangements, and if you would like us to help you in reviewing yours, then please let us know.

In this respect, you might like to consider one of the following:

1. Do you still need your trust? If not, we can wind it up. This will involve making final distributions, liaising with the IRD, and completing resolutions to wind up the trust. It's always a good idea at this point to make sure that your wills and EPAs are also up to date.

2. Do you have a trust that is no longer relevant to your circumstances or part of a group of trusts that needs to be streamlined? Maybe you should consider a resettlement. We would be happy to review your arrangements and help you finesse your arrangements.

3. Or maybe you need a hand working out how compliant your current trust arrangements are and whether you should vary an existing trust to bring it into line with the new Trusts Act.

Equally, now might be the time to set up a new trust. We can prepare a new trust deed that is compliant with the new Act and incorporate a corporate trustee for ease of trustee arrangements. Asset transfers, IRD requirements, and trust register compliance will be included.

Please get in touch if you would like us to assist you in any of these matters. We are happy to discuss your particular requirements and to estimate your likely costs in making these arrangements.

Our Website…. Read our newsletters online at www.speakmanlaw.co.nz.

Come visit…

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