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*Welcome to the first issue of Commercial eSpeaking for 2008. We hope you find the articles both useful and of interest to you. If you would like specific business or commercial topics covered in future editions, please get in touch with us. The next issue (the 19<sup>th</sup>) will be published in May.*

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## Taxing Property Transactions - When buying, be careful

*Many of you may have seen the "Property Climbers" programme on television which must greatly amuse the Inland Revenue Department. This article looks at the tax implications for people who regularly buy and sell property.*

Most people do not fully appreciate the tax implications of property transactions. The Inland Revenue Department (IRD) has dedicated task forces that are solely dedicated to investigating property transactions. The IRD focuses on *anyone* buying and selling property, not just developers who do it for a living.

There are many misconceptions about the tax obligations on the sale of property. Sections CB 5–13 of the Income Tax Act 2004 (the Act) set out the rules.

Any property purchased with the intention of resale will result in tax being payable on any profit. The intention of resale does not have to be the dominant intention - merely an intention to sell, amongst other intentions, suffices to capture the income as taxable. It also does not matter how long the property was owned or what its use was prior to sale.

When the IRD audits property transactions, it obtains information from a number of sources including lenders and consent applications at councils. These organisations are legally obliged to disclose their files to the IRD. The IRD looks for such things as file notes made by bank personnel which may indicate the purchaser's intention when they applied for finance. Any mention of a possible resale to a lender may seal your fate. Of course most people intend selling their family home at some stage; just don't tell your bank.

### Exemptions

There are exemptions for the sale of your personal residence, but the exemption is negated if there is a regular pattern of acquiring and disposing of, or erecting and disposing of dwellings. This can capture 'property climbers' buying a house, living in it, renovating and then selling. There is no magic number of transactions that are acceptable to the IRD. Once a regular pattern is established, profits are taxable. Under the complex associated person rules, all family members will also be captured as property dealers, and they may become accidental taxpayers.

Builders are subject to a special set of rules. In this context 'builder' means anyone in the business of erecting buildings. Building company employees would generally be exempt, unless they are caught by the associated person rules. Taxable income can arise where a builder, or someone associated with a builder, acquires property, including their personal residence, and irrespective of the intention when acquired, then makes improvements to the property. If the property is sold within 10 years of making those improvements, any profit will be taxable. The improvements must be of more than a 'minor nature' which is very subjective.

Subdivision of land around a family home can also be a taxable activity. There is an exemption available, but much depends on the number of lots in the subdivision and the extent of the work necessary to achieve the subdivision. The creation of any more than two lots would most likely be captured as a land development business. It should be noted that the exemption is not available to land owned by a trust.

### Be careful

The above outlines are simplistic, but the rules are not. We strongly recommend that you consult us if you are contemplating subdividing, buying or selling property, not when the deal is done.

## Charities Commission

### - The pressing matter of registration by 1 July

*While many readers will have heard about the need to register charities it is worth reiterating the need to register by the deadline of 1 July 2008 is fast approaching.*

In 2007 the Charities Commission established a Charities Register in New Zealand. The aim is to make more information about charities available to the public in the hope of building and maintaining public confidence in the charitable sector. To date over 1,550 charities have completed the registration process.

#### **Primary benefit of registration**

The practical implication of the Charities Register is that now only those charities that register with the Charities Commission will be eligible for a tax-exempt status regardless of whether the organisation has previously enjoyed this privilege. All charities must be registered by 1 July 2008 to obtain or retain these tax benefits.

#### **Timing**

It is vital for all existing and new charities to ensure their applications for registration are completed promptly to obtain these benefits. Applications are currently taking 14 weeks to process once properly completed and the queue stands at over 3,900 applications. As the cut off date approaches longer processing delays are expected.

If you wish to ensure that your charitable organisation continues to receive tax exemptions then it is essential to attend to this matter without delay.

Before making application, there are however a number of specific timing issues that are worth considering.

#### **Annual returns**

Once the registration process is complete the registered charity is required to file an annual return, including a balance sheet and financial statement, within a six month window following the charity's balance date. Therefore if a charity registers just prior to their filing date they will only have six months to complete the return.

If a charity registers immediately after its balance date (but before 1 July 2008) its first annual return is not due until after the end of the year. This can create more time for the charity to implement new systems to get its financial reporting up to scratch.

You should however be wary of jeopardising the charity's tax status if registrations cannot take place after the balance date and still meet the 1 July 2008 deadline.

#### **Changes of officer**

If your charity is likely to have a change of officer at an approaching AGM then it may be preferable to delay registration to cut down on unnecessary paperwork.

When an officer changes, both the original officer and the new officer must complete a form for the Commission. Holding off the application may avoid this and allow registration to take place at a time when the charity's group of office holders are more secure.

Again it is essential that the cut off date remains at the forefront of all considerations. If timing issues do not affect you then filing sooner rather than later would be prudent.

#### **Filing requirements**

As part of the application process your charity must submit a copy of its governing document (i.e. trust deed or constitution) for registration. If these need updating or they do not fulfil the criteria outlined by the Commission or you need assistance filing financial accounts then please feel free to contact us.

## Business Briefs

### Securities Markets Amendment Act 2006 and Regulations

The Securities Markets Amendment Act 2006 (which amends the Securities Markets Act 1988), together with its associated regulations, is to come into force on 29 February 2008. The Act will introduce amendments to the insider trading, substantial security holder disclosure, and investment adviser and broker disclosure regimes in New Zealand, and will introduce a new market manipulation regime. Some of the notable changes or additions include:

- Expanding the scope of who constitutes an insider (who is prohibited from engaging in certain share trading activities) so that it will include (broadly) any person in possession of materially price sensitive information that is 'not generally available to the market' and who 'knows or ought reasonably to know' that this is the case (contrasting with the current law, which requires an insider to have a connection to the public issuer to which the inside information relates)
- Introducing new market manipulation laws which prohibit making false or misleading statements or spreading information which is likely to induce a person to trade or which might affect the price of the securities and prohibits creating a false or misleading appearance of securities trading, and
- Introducing new disclosure laws for investment advisers and brokers under which more information is required to be given to clients, especially about fees remuneration and other interests and which requires fuller disclosure to be made up-front before investment advice is given to, or investment money or investment property is received from, clients.

The new law affects investment advisers, brokers and market participants, and should provide more certainty to the securities market generally.

### Property Law Act 2007

The Property Law Act 2007 (which replaces the Property Law Act 1952) came into force on 1 January 2008. The purpose of the Act is 'to restate, reform and codify (in part) certain aspects of the law relating to real and personal property'. The Act clarifies and modernises many complex and technical rules contained in the previous Act and aims to create modern, user-friendly legislation for people involved in buying or selling property, mortgage and finance transactions and commercial leasing.

The new Act introduces a number of new concepts including:

- The purchaser's right under an agreement for sale and purchase to claim the return of the deposit in circumstances where the purchaser is not entitled to cancel the agreement and no court will order specific performance of the agreement by the purchaser
- A short term lease, which is an unregistered lease for a term of one year or less;
- Mandatory forms and procedures when serving certain notices under the Act (such as a mortgagee's notice to call up a mortgage, exercise their power of sale or enter into possession, and a landlord's notice of intention to cancel a lease for the breach of a covenant or condition).

The new Act also abolishes and replaces a number of old concepts. For example, the landlord's right of distraint (the right to seize the tenant's goods for rent arrears) has been abolished and the antiquated concept of 'forfeiture' has been replaced with the term 'cancellation'.

Property sellers and buyers will notice that many of the standard forms and documents used during a transaction have been replaced. In particular, lenders and landlords should seek advice regarding their obligations under the new Act.

## The Companies (Minority Buy-Out Rights) Amendment Bill

This Bill was introduced to the House in November last year. It seeks to protect minority shareholders by clarifying the minority buy-out provisions in the Companies Act 1993 in relation to special resolutions that:

- Alter the company constitution in a way that imposes or removes a restriction on the company's activities, or
- Approve a major transaction, or
- Approve an amalgamation proposal

Where a minority shareholder unsuccessfully opposes a special resolution above, they may require the company to purchase their shares. Under the existing provisions, a company must offer a dissenting shareholder a 'fair and reasonable price' for the shares. However, the Bill does not provide any guidance as to how that price should be calculated. The new bill provides a statutory framework for calculating an 'honest estimate' of the value of the shares. The bill imposes an obligation on the company to send the dissenting shareholder a statement setting out the shareholder's rights under the new provisions, and a statement outlining how the fair value of the shares was determined. The amendments include that the:

- Share price must be calculated from the date the company gives the dissenting shareholder notice that it will purchase the dissenting shareholder's shares
- Valuation of the shares be adjusted to disregard any change in the valuation attributable to the event that was decided by the special resolution (except where the dissenting shareholder is being bought out against the shareholder's will), and the
- Price may be determined by arbitration if the shareholder and the company cannot agree.

The closing date for submissions is 29 February 2008.

## Consumer Guarantees Act and remedying defective consumer goods

In *Acquired Holdings Ltd v Turvey (CIV 2006-404-7284)* heard in Auckland's High Court in November 2007, Mr Turvey purchased a motor vehicle from a registered motor vehicle trader (the supplier for the purposes of the Consumer Guarantees Act 1993 – the CGA). Six months after the purchase of the vehicle certain defects appeared which Mr Turvey had repaired by a third party. Mr Turvey then filed a claim against the supplier for the repair costs and for general damages.

The High Court overturned the District Court decision and held that where the defect can be remedied and is not of a substantial character, the purchaser must follow the requirement in the CGA and must, in particular, allow the supplier the opportunity to remedy the failure or defect within a reasonable time.

The Judge referred to the underlying policy of the CGA, that businesses should bear the risk where the goods and services they supply fail to comply with consumers' reasonable expectations. The High Court held that Mr Turvey was not entitled to claim under the CGA for the repair costs from the supplier, as he had failed to give the supplier the opportunity to remedy the defects first. However, the High Court did award Mr Turvey damages for consequential loss under the CGA.

This decision sends an important message to consumers that they should always ask the supplier to remedy any defect in consumer goods first. Consumers should avoid taking matters into their own hands as they may lose out altogether where they arrange for a third party to repair defective consumer goods.