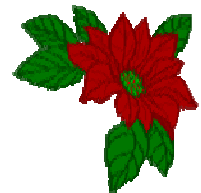


Merry Christmas and a happy and safe New Year



Inside this edition

Beware When Changing Trustees	1
Taxing Grass and Fertiliser	2
Income Tax Act 2004 – New and Improved?	2
Australian Property Investments	3
Little Snippets	4
No More Time and a Half for Sick Days.....	4
Timeframes for Tax Refunds ..	4
Smoke Free at Last	4
Oral Agreements and GST Implications.....	4

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Beware When Changing Trustees

When a trust has an investment in a company, the shares are effectively in the trustees' names, i.e., the trustees are the joint legal owners of the shares. When there is a change in the trustees of a trust, the legal ownership of the shares will change to joint ownership by the new trustees. This process is not automatic - there needs to be a transfer of shares to the new trustees.

When trustees change, it is important to check that the company's constitution has particular provision for a transfer to the new trustees without triggering pre-emptive rights. It was exactly this type of situation which was highlighted in a recent case, *Calan Healthcare Properties Limited*. There was a change of trustees for one of the shareholders. A share transfer was duly executed, but the directors refused to register the transfer on the basis that the transfer triggered the other shareholders' pre-emptive rights. The company's constitution obviously did not have a provision which provided that transfers to trustees did not trigger pre-emptive rights. Specific provisions which "bypass" pre-emptive rights where shares are transferred to related persons (including trustees) are commonly found in company constitutions.

The trustees in the *Calan* case argued that the pre-emptive rights did not apply to a trustee change because there was

no change in the beneficial ownership of the shares. The Court disagreed – the transfer of shares under the constitution was a reference to the transfer of legal ownership. Therefore, the transfer to the new trustees effectively triggered the pre-emptive provisions in the constitution.

Therefore, before changing trustees, it is important to check the company's constitution in relation to pre-emptive provisions. In the majority of cases, the companies would be small and closely

held, where the shares might be held by a family trust and a number of family members. Or the company might be held by the family trusts of two or more business partners. Even where the companies are closely held, if there are no provisions in the constitution to “bypass” pre-emptive rights, waivers of pre-emptive rights should be signed by the other shareholders. Transfers to new trustees can be done with impunity if there are provisions allowing the pre-emptive rights to be “bypassed”.

Taxing Grass and Fertiliser

In recent times, dairy and other farm conversions have become increasingly frequent. The appropriate treatment for expenditure required for the conversion is now in question. The issue is whether the conversion costs are capital, because the use of the asset is being changed, or deductible as normal farming expenditure.

The IRD issued an operational statement to state its position on conversion expenditure. The statement attempts to set out what expenditure is on revenue account and what expenditure is on capital account. The IRD considers that ordinary agricultural expenditure will be of a revenue nature where the work or asset in question does not result in any ‘materially or substantially different’ asset or subject matter that the work relates to.

In contrast, expenditure will be capital where the asset has had substantial and extensive work done to it resulting in a ‘materially or substantially different’ asset.

The IRD view is that where the land conversion or project is on capital account, it will treat all the costs relating to the conversion or project as capital. This will have implications for normally deductible expenditure, for example, grassing and fertiliser. The main issue in dispute with the IRD is the tax treatment of grassing and fertiliser. The IRD's view is that in a farm conversion, the land which is being grassed and fertilised is part of a capital project to change the use of the land.

The operational statement was issued on 5 July 2004, and the IRD has stated that it will apply the statement to grassing and fertiliser expenditure incurred after 5 July 2004. For expenditure incurred before that date, the IRD will not audit the treatment of grassing and fertiliser in tax returns filed by 31 March 2005. After 31 March 2005, taxpayers will need to be aware of the possibility of an audit if they take a tax position which is different to the IRD's position in the operational statement.

Income Tax Act 2004 – New and Improved?

We have a new Income Tax Act! Is it a new and improved Act? Do we have more certainty? More clarity? This remains to be seen as we come to grips with it.

The Income Tax Act 2004 (“2004 Act”) is a substantial rewrite of the Income tax Act 1994 (“1994 Act”). The 2004 Act will take

effect from the 2005/06 tax year. This 2004 Act applies as early as 1 October 2004 for taxpayers with early balance dates. The aim of the rewrite was to enhance the clarity of the existing legislation without making significant changes to the law. There are, however, some intended policy changes in the 2004

Act, and they can be found in Schedule 22A. These are mainly minor changes or clarification of existing rules. Some intended policy changes include:

- *Land and Associated Persons* – generally, the test of association for land transactions applies at the time the land is acquired (not at disposal). In relation to builders, the test will apply at the time the land improvements are completed. Therefore, where a person is not associated with a builder at the time of acquisition of property, but later becomes associated when improvements are carried out, a gain realised on the property may be subject to tax. Conversely, the property will no longer be caught by the association rules where the person was associated with a builder at the time of acquisition but was not associated when improvements are carried out.
- *Timing of Income Recognition* – this change will alter the timing of when certain income is recognised. This means there will be no need to alter any past tax returns where liabilities are remitted or cancelled or expenditure is recovered, for example, from insurance claims. The amounts will now be returned in the year the liability is remitted or cancelled or when the expenditure (previously claimed as a deduction) is recovered.

- *Motor Vehicle Expenditure* – IRD mileage rates may now be used to calculate the business use of a vehicle (up to a maximum of 5,000km per year for each person).
- *Farm Land Expenditure* – this change clarifies the timing of deductions and prevents potential overlaps in relation to some farmland deductions and amortisation.
- *Livestock Valuation* – the rules have been amended to ensure that a valuation election made for partnership livestock does not apply to a partner's other interests.

A key issue with the 2004 Act is how taxpayers should deal with unintended policy changes or uncertainties resulting from the rewrite. The IRD has issued an exposure draft to deal with uncertainties that arise as a consequence of unintended policy changes. The IRD has indicated that penalties and interest will be remitted where:

- The taxpayer relied on the 1994 Act, and the 2004 Act is found to be different.
- The taxpayer relied on the 2004 Act and the 2004 Act is subsequently amended.

Therefore, reliance can be placed on either the 1994 Act or 2004 Act, provided the interpretation of either Act is acceptable.

Australian Property Investments

For the numerous people who have invested in properties on the Gold Coast, there has been some confusion in relation to their responsibilities for tax deductions when interest is paid on borrowings used to finance the properties. To clarify when non-resident withholding tax "NRWT") is payable, IRD released an Exposure draft which states that:

- Where the Australian financial institution to which interest is paid has a branch in New Zealand (e.g.

WestpacTrust), NRWT **will not** be payable on the interest.

- If the Australian financial institution does not have a branch in New Zealand, NRWT **will be** payable on the interest unless the investor has a place of business in Australia.
- If the investor has more than one residential investment property in Australia, they may have a place of business in Australia. If they do, then

the investor will not have to pay NRWT on the interest.

- Where property managers are involved, NRWT will not be payable if the property manager works as a property manager only for the investor (a dependent agent). If the property manager is able to act independently of the investor in the

normal course of his or her business (an independent agent), NRWT will be payable on the interest paid.

The Exposure Draft provides useful guidance on the nightmare involved with NRWT and interest paid to overseas financial institutions.

Little Snippets

No More Time and a Half for Sick Days

Under the Holidays Act 2003, employees who had sick days on a public holiday, may have been able to claim pay at time and a half. Unreasonable? Probably, but that was a possible interpretation of the law. To remove that unintended possibility, the law was amended so that employees are now no longer able to make such a claim. Sick days will only be paid at usual pay rates.

Timeframes for Tax Refunds

Under current law, taxpayers are able to claim refunds up to a period of eight years for excess tax paid. In proposed legislation, that timeframe reduces to four years except where there has been a "clear mistake" or "simple oversight" on the taxpayer's part. Unfortunately, the IRD has not been forthcoming about what it considers to be a clear mistake or simple oversight – so watch this space!

Smoke Free at Last

No more smoking in the workplace! From 10 December 2004, employers must not allow employees to smoke in the workplace. This will mean that employers cannot provide a dedicated "smoking room" for employees to smoke in.

The exception to this rule is where the workplace is, or is part of, a hospital care institution, residential disability care institution or a rest home, and smoking takes place in dedicated smoking rooms which are ventilated.

Oral Agreements and GST Implications

A recent High Court case highlights the importance of checking a written formal agreement to ensure consistency with a prior oral arrangement between parties involving a property transaction. The purchaser argued that the parties had an enforceable oral agreement for the sale and purchase of a farm at a price of \$1 million plus GST (if any). The vendors were not GST registered and the purchasers maintained that they did not have to pay more than \$1 million for the farm property. However, the subsequent written agreement stated that the sale price was \$1,093,750 inclusive of GST. The sale was not completed and subsequently cancelled by the vendor.

The Court concluded that the parties had not reached a prior binding oral agreement and that the parties did not intend to be bound until a formal written agreement was executed. The initial written agreement was for \$1 million plus GST (if any); however, the vendor's solicitor subsequently amended the price to \$1,093,750 inclusive of GST. The agreement was signed by both parties. The Court held that the vendors were entitled to retain the forfeited deposit of \$50,000 paid by the purchasers.

If you have any questions about the newsletter items please contact us, we're here to help.