Estate and Taxation Planning Council New Zealand Inc

August 1996

Dear Member

Fourth Estate

There has been some consternation in the ranks of your Executive Committee in recent months. There has been anxiety. There has been fear. Why? Falling member interest and attendance at our functions. Either we don't receive responses back in good time for planning purposes (meaning that the Committee has to spend the additional time to phone around to members) or else, with good responses, members simply fail to turn up to events – usually without giving us the courtesy of an apology!

The Executive Committee were more than disappointed at the extraordinarily poor response to what was considered to be a key speaker for the Council's Annual General Meeting – the Retirement Commissioner, Colin Blair. Worse yet was the discourtesy demonstrated by a number of those members who *were* interested enough to attend – but lacked the good manners to arrive on time.

In May, we chose what we thought would be a topical and *helpful* subject: the machinations of voting in an MMP election. Our speaker, Dr Paul Harris, demonstrated an expert knowledge of his subject and presented an interesting and informative talk.

For our July meeting, again we chose a topic that simply couldn't have been more timely or appropriate for our members. However, the Committee nearly had to cancel the meeting altogether, because so few members had bothered to respond to the invitations. We didn't know for certain that we had viable numbers for an audience until the week before the seminar – and, understandably, the speakers were growing concerned about being asked to put significant time and effort into preparing their presentations when there was so little interest being shown by members.

If, despite the many complimentary remarks that are made by members after each seminar, the Committee is not fulfilling members' expectations, then we'd like to hear about it.

If there are topics or speakers that members would prefer to see featured, please let us know about them.

Each of us on the Committee devotes a number of hours free each month to organising functions for the membership – we would hate to think that our efforts are worthless.

The acid test is coming with the 20th Anniversary Celebration on Tuesday, 10 September. Surely we can improve on response times and actual attendance on the day?

The Capital Gains Trap – Seminar 25 July

Des Trigg, through the use of overheads, examples, and discussion, demonstrated the overall position for individual investors. Unit Trusts are taxed as companies and therefore their distribution is by way of dividends and the Unit Holders can then sell (either direct redemption or buy back). Group Investment Funds (GIF) are different in that they can either be taxed as companies in the same way as Unit Trusts or alternatively they can be taxed as qualifying trusts. In the latter case the distribution then is by way of beneficiary income.

Des then talked about three different areas with firstly, financial arrangements being caught by the accruals regime; the equities position Des advised that the jury was still out; and thirdly, for property section CD1 of the Tax Act applies.

After putting up four different examples of distribution of income Des then dealt with the suitability of the sales options as follows:

	Manager Buy Back	Direct Redemption
Traders	No	Okay
Superannuitants	Okay	No
33% tax rate	Neutral	Neutral
Less than 33% (i) Other income	No	Okay
(ii) No other income	Neutral	No

Des did note that for the Direct Redemption the "slice rule" option is used as in all cases the reverse ordering rule is not suitable.

There was then some interesting discussion on passive investment as opposed to a trader. There does seem to be some inequality on the treatment of Fund Managers as opposed to individual investors. Des pointed out some of the matters for an investor to be considered a passive investor. These were frequency and size of transaction, the number of investment reviews, the length of time that the shares were owned, the purpose of borrowing moneys, and the selection of shares.

A small trap that clients might fall into would be to emphasize the profit element and the attractiveness of the investment with the bank manager in order to get the appropriate loan. Also if the shares being purchased were volatile with a low dividend yield this might reinforce the IRD argument of purchasing with a view to profit. The importance factor is the intent of the individual/Fund Manager at the time of **acquisition!** – (not at any later date).

Ross Stitt focused his part of the seminar on a number of legal points. Under common law capital gains are not taxable but the Tax Act comes in over top of the common law. There are four areas when capital gains might be taxable:

- Business profits
- Dealing in particular assets
- Acquiring assets for the purpose of resale
- Profit making purpose scheme

Ross outlined the old "California Copper" case where the gain on an asset in the ordinary course of business is taxable. This general principle was applied to banks and insurance companies. Ross did not consider the "Alexander" case to be a particularly useful case in terms of its reasoning.

More time was spent on the "Rangitira" case where Ross outlined the move by the IRD to change the company from a capital account shareholder to a revenue account shareholder in the mid-1980s. The Court of Appeal said that the company was not a passive investor at all and that all the gains were taxable. The Privy Council decision is coming out in September/October 1996 and Ross predicted that the Privy Council will overturn the Court of Appeal. Ross felt that the Privy Council might still hold some of the gains to be taxable and in particular the dealings in respect of the Brierley subsidiary companies, but that this does not necessarily taint all of the other activities of the taxpayer.

Ross suggested that many managed funds have now made an allowance for tax, partly because of the change in law on how funds can be distributed and partly because of the practical problems in being equitable to past, present and future Unit Holders. The IRD is reluctant to give advance rulings and it is difficult to frame a suitable application for a binding ruling without being too restrictive or running the risk of not making full disclosure.

The TeNZ Fund is not caught under any of the four headings for capital gains. It is a Tracking Fund with no intention to make a profit, no management, and it is not carrying on a business of any kind, and is not a dealer. There is still a tax issue with the buyer of the units and the TeNZ Fund now has the same distribution problems as other Unit Trusts. It is, however, listed. It is dangerous to reply on IRD policy statements as these can change in the future.

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Ross dealt briefly with off-shore trusts and there seems a possibility of investing in a United Kingdom fund that then buys in New Zealand. There does not appear to be much interest at present in using off-shore trusts at this point in time.

Report contributed by Steve Murray

Stop Press

Change of Date/Venue

20th Anniversary Celebration of Council – Guest Speaker: Rt Hon Bill Birch, Minister of Finance.

When: 5.30 pm Tuesday, 10 September
Where: Royal New Zealand Yacht Squadron, Westhaven