

THE LAW

LOWDOWN

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BARRISTERS AND SOLICITORS

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Welcome to the latest edition of the Law Lowdown.

The new Government has made a number of changes to the law and we touch on the changes to the Brightline tax test in this newsletter.

We look into the complex area of buying a business.

As a result of enquiries we often get from our clients, we cover some practical things you can plan for now that may make things easier and less costly at the time of the passing of a loved one.

As always, we encourage you to contact us if anything here, or elsewhere, is causing you concern.

Regards

The team at Magill Earl

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BUYING A BUSINESS IN NEW ZEALAND: KEY CONSIDERATIONS



Buying a business in New Zealand can be both exciting and stressful. It marks the start of a new adventure, but usually involves some uncertainty and risk.

START A NEW BUSINESS INSTEAD?

An existing business should offer an established customer base and cashflow. However, you also inherit existing challenges and may need to make changes to align the business with your vision. Starting a new business allows you to develop everything to your specifications but requires new customers and establishing a market presence from the ground up.

ENGAGING PROFESSIONAL ADVISORS

If you decide to buy a business, it is critical to get professional help and get it as early in the process as you can. Your lawyer and accountant can provide valuable input and advice to help you make an informed and de-risked decision. These advisors assist you to ensure that all necessary considerations and issues are identified and addressed.

THE AGREEMENT

One of the first steps in buying a business is finalising the agreement. We strongly advise using the standard Legal Agreement for Sale and Purchase of a Business, compiled by what is now known as The Law Association (formerly the Auckland District Law Society). This agreement has terms and conditions well understood and accepted in the market and covers most matters that usually need to be considered. Key elements to consider include:

- Names of the vendor and purchaser
- Description of what is being sold
- Price and terms of payment
- Warranties by the vendor
- Conditions such as obtaining suitable finance and due diligence
- Possible restraints of trade
- Issues related to existing employee contracts

Make sure your lawyer reviews the agreement before signing to ensure all critical elements are covered and to identify any potential issues.

WHO OR WHAT SHOULD BUY?

Choosing the right purchasing entity is essential. That choice is likely driven by such matters as limited liability protection, tax considerations, and succession planning. Common options include sole proprietorship, partnership (including limited partnership), limited liability company, and trading trust. Including “and/or nominee” in the purchaser’s name in the agreement allows for flexibility while you discuss the most appropriate entity with your lawyer and accountant.

DUE DILIGENCE

The importance of a thorough due diligence process cannot be overstated. This means a detailed analysis of the business to ensure you are making a sound investment. Key aspects may include:

- Reviewing the business’s leasing and licensing arrangements
- Examining customer and supplier relationships and contracts
- Considering staffing levels and contracts, and interviewing key staff
- Reviewing stock valuations
- Validating asset ownership including checking for any lending securities that may be in place to secure loans made to the business
- Understanding any intellectual property rights being bought
- Analysing financial statements from the past several years

While most due diligence typically occurs after signing the agreement, much of this work can be done beforehand to inform your offer.

BEWARE UNDERESTIMATING TIME

Both buyer and seller usually aim to complete the deal quickly, but delays can occur due to involvement from other parties protecting their own interests. For instance, if the business is in a leased property, landlord consent is required for lease transfer, which can take time. Plan for a few weeks of due diligence and finance arrangement, followed by additional time for landlord consent and other approvals.

MORE ON THE SALE AND PURCHASE AGREEMENT

As we have said, although many business sale and purchase transactions use the standard The Law Association Agreement, and this covers most things, some situations may require additional terms. Examples include:

- Particular employee-related issues
- Vendor finance
- Purchase price “earn outs”
- Additional vendor warranties about the business
- Handling work in progress at settlement

If the purchasing entity is a company with multiple shareholders, a Shareholders’ Agreement is vital. This records the rights and obligations of each shareholder, covering matters such as:

- Incapacity of a shareholder
- How shares will be sold including pre-emptive rights to

other shareholders

- How shares are to be valued in the event of a sale
- Any restraints of trade on a selling shareholder
- Dispute resolution processes

A Shareholders’ Agreement may prevent future conflicts and expenses by providing clear guidelines for common eventualities.

RELATIONSHIP PROPERTY

Finally, buying a business in New Zealand could have implications under the Property (Relationships) Act, as the asset may be, or become, relationship property. This means its value could be subject to equal division between partners upon separation, affecting ownership and financial arrangements. Legal advice is crucial to navigate these implications.

CONCLUSION

Buying a business in New Zealand requires careful planning and consideration. Consulting with your lawyer and accountant early in the process ensures a smooth transaction and awareness of potential issues. While professional advice comes at a cost, it is often far less than the cost of encountering problems later. By following these steps and seeking professional guidance, you can navigate the complexities of buying a business and increase your chances of enjoying a successful and rewarding venture.

UNDERSTANDING THE BRIGHTLINE TAX TEST

The Brightline tax test is a crucial part of New Zealand’s property taxation framework, designed to curb property speculation and ensure that profits from quick property sales are taxed appropriately. Introduced in October 2015, the test has undergone several changes, reflecting the governments’ ongoing efforts to stabilize the housing market and address affordability issues.

The new Coalition Government brought in changes to the Brightline test with effect from 1 July 2024.

HOW DOES IT WORK?

The Brightline test determines whether the sale of residential property is subject to income tax based on the duration of ownership. Initially, the test applied a two-year period; properties bought and sold within two years were subject to tax on any capital gains. This period was extended to five years in March 2018 and then to ten years in March 2021 for properties acquired after the extension.

The latest changes mean that if you sell a property on or after

1 July 2024, the Brightline test looks at whether your Brightline end date for the property is within 2 years of your Brightline start date.

If you sell a property before 1 July 2024, the sale will come under the Brightline test if the following apply;

- You bought the property on or after 29 March 2018.
- You are selling it within 5 years or before 1 July 2024 (whichever comes first).

CALCULATING THE BRIGHTLINE PERIOD

The start date for the Brightline period is the date the property’s title is registered to the purchaser. The end date is the date the purchaser enters into an agreement to sell the property. If a property is held beyond the applicable Brightline period, it is not subject to the test.

KEY EXEMPTIONS

Certain exemptions are built into the Brightline test to ensure it targets speculators rather than ordinary homeowners.

Main Home Exemption: The most significant exemption is for a person's main home. If the property has been used predominantly as the owner's primary residence, it's typically exempt from the Brightline test. The law has changed so that this exemption will only apply if;

- you used more than 50% of the property's area as your main home; and
- you lived in the property as your main home for more than 50% of the time you owned it.

If you build on the land, you do not have to include the construction period when determining if your usage of the property qualifies for the main home exclusion.

However, frequent buying and selling of main homes can still attract scrutiny and potential taxation.

Inherited Property: Properties inherited are exempt from the Brightline test, recognising that these are often not acquired through typical market transactions.

Relationship Property Transfers: Transfers of property due to the end of a relationship, covered by the Property (Relationships) Act, are also exempt, ensuring fair distribution without additional tax burdens.

IMPLICATIONS FOR PROPERTY OWNERS

Owners selling a property within the Brightline period must pay income tax on the capital gain. This gain is the difference between the sale price and the acquisition cost, adjusted for any allowable expenses, like renovation costs or legal fees. It's important for property owners to maintain comprehensive records to substantiate these expenses and accurately calculate the taxable amount.

COMPLIANCE AND PENALTIES

Failure to comply with the Brightline test requirements can result in significant penalties. The Inland Revenue Department (IRD) actively monitors property transactions and expects accurate reporting of property sales and corresponding tax obligations. Owners are encouraged to seek professional tax advice to ensure compliance with the complexities of the Brightline test.

CONCLUSION

The Brightline tax test is designed to manage property market dynamics and discourage speculative investments. Taxing profits from quick property sales creates a more stable and affordable housing market. Property owners must understand the implications of the Brightline test, including the periods, exemptions, and compliance requirements, to avoid unexpected tax liabilities and penalties. Continuing to stay informed about legislative changes and seeking professional advice remains essential for property investors and homeowners alike.

PRACTICAL STEPS TO AVOID FINANCIAL DIFFICULTIES AFTER THE DEATH OF A PARTNER OR SPOUSE

The death of a partner or spouse is an emotionally challenging time, often compounded by the practical difficulties of managing finances and paying for expenses. Understanding how joint accounts work and the requirements of obtaining probate can help streamline financial matters during such times.

In running a busy Estates practice, we often see things happening where delays and extra costs are incurred when they might have been avoided. So we thought it could be helpful to identify some of the practical steps that can be taken to avoid financial difficulties after the death of a loved one.

JOINT ACCOUNTS

Having a joint bank account with your partner or spouse can be incredibly useful. On the death of one account holder, the surviving partner usually retains access to the funds without the need for probate. This access can provide immediate financial relief to cover urgent expenses such as funeral costs, household bills, and other necessities.

Regularly review and update the documentation associated with joint accounts to ensure both names are correctly listed. Ensure that the bank has up-to-date contact information and identification for both account holders.

PROBATE REQUIREMENTS

Probate is the legal permission granted by the High Court which confirms a will's validity and the authority of the executors to administer the deceased's estate. If your partner or spouse dies with assets solely in their name, these assets may be frozen until probate is granted. This process can take several months, potentially delaying access to funds needed for immediate expenses.

PLAN WITH WILLS AND FAMILY TRUSTS

Ensure that you and your partner or spouse have valid, up-to-date wills that clearly outline the distribution of assets. A well-drafted will can speed up getting probate and reduce the likelihood of disputes, providing quicker access to funds.

Establishing a family trust can be an effective way to manage assets and provide for your loved ones. Assets held in a trust are not subject to probate, allowing for immediate access and avoiding delays and legal complexities.

INSURANCE AND OTHER FINANCIAL PRODUCTS

Do you and your partner have adequate life insurance coverage? Life insurance payouts are typically processed quickly and can provide essential funds to cover expenses during the probate process.

Regularly review and update beneficiary designations on life insurance policies, retirement accounts, and other financial products. This ensures that the funds are directed to the intended recipients without the need for probate.

We encourage our clients to keep detailed records and maintain a list of all financial accounts, insurance policies,

and other assets. Details should include account numbers, contact information for financial institutions, and any relevant passwords. This information should be shared with a trusted family member or legal advisor.

PRE-PAID FUNERAL PLANS:

Anyone watching mainstream television these days will know of the pre-paid funeral plans to cover the costs associated with the funeral and burial. For some people this can be an appropriate way to alleviate financial pressure on the surviving partner and ensure that funeral arrangements are carried out according to the deceased's wishes.

LEGAL ADVICE:

We don't apologise for recommending our clients to consult with a legal professional to discuss estate planning and probate processes. Lawyers and experienced Legal Executives can provide tailored advice based on your specific circumstances and help you implement strategies to minimize financial difficulties.

CONCLUSION

Taking proactive steps in financial planning and understanding joint accounts and probate requirements can significantly ease the financial burden during the difficult time following the death of a partner or spouse.

By maintaining joint accounts, ensuring proper documentation, planning with wills and trusts, securing insurance, and seeking professional advice, you can ensure smoother financial management and focus on what really matters - honouring the memory of your loved one and supporting your family.

UNDERSTANDING CROSS-LEASES: THINGS TO LOOK OUT FOR

There is often confusion about the type of legal title known as Cross-Leases. In this article we identify how they came about and what issues can be encountered with them.

INTRODUCTION

Cross-Leases were created in the 1960s to exploit a legal loophole. This had to do with planning rules around subdivision restrictions. Many developers, and homeowners intending subdivision and building on their own properties, wanted to avoid the extra time, complexity and costs required to get conventional freehold (or fee simple) title.

So the cross lease was born.

A cross lease is a form of property ownership where two or more parties own a, usually, equal share in the freehold title to the whole property but then lease parts of the land and buildings to each other. The method involves all the freehold owners granting (by registered lease) the exclusive right to occupy a specific unit or dwelling and other improvements on that land for a set period, often 999 years. The arrangement often includes shared ownership of common areas, like driveways and gardens.

Cross-leases are seen most commonly in urban areas, with nearly half in the Auckland region. The issues which we will now address have played a part in the preference for Unit Title development which is generally seen as better. We will talk more about Unit Titles in our next Newsletter.

LEGAL ISSUES ASSOCIATED WITH CROSS LEASES

The issues with cross-leases have been known for a long time, and both property owners and potential buyers must understand them.

Alterations and Additions: A very common legal issue with cross leases comes when an owner wants to make alterations or additions to their home. Under most cross lease provisions significant changes to the property require the consent of all the freehold owners. Disputes are common, if not inevitable, and if alterations are made without the necessary consent, they may not be legally recorded in the title.

Definition of Exclusive Areas: In some older cross-leases, the areas each owner is entitled to occupy may not be clearly defined, or the boundaries may have changed over time without proper legal updates. This can lead to disputes over land use and maintenance responsibilities. It's essential to ensure that any changes to the property layout are accurately reflected in updated plans and lease documents recorded against the property's title.

Maintenance and Repairs: Maintenance responsibilities under cross leases can also be a source of contention. Generally, each owner is responsible for the upkeep of their home and any ancillary buildings, and the land immediately surrounding

them. However, disputes can arise over the maintenance of shared spaces and common areas, especially if the lease agreement is unclear or silent on these issues. It is very important for cross leases to clearly outline the maintenance obligations of each owner concerning common areas to avoid conflicts.

Insurance: Insurance for cross lease properties can be more complex than for standalone properties. While individual units can be insured separately, common areas typically require joint insurance. This can lead to complications if owners disagree on the level of coverage or the choice of insurer.

Where units are in closer proximity to each other it may become more important to ensure proper replacement insurance is in place for all buildings.

Sale and Transfer of Ownership: When selling a property under a cross lease, it is essential to disclose all relevant details about the lease, including any alterations made without consent, and disputes with co-owners. Failure to do so may lead to legal challenges.

Buyers should be aware that they are not only purchasing a physical dwelling but also entering into a legal relationship with the other co-owners. The terms and conditions of the lease need to be carefully read and understood.

CONCLUSION

In conclusion, while cross leases offer a practical solution for shared property ownership, they come with specific legal challenges that require careful consideration and demand the assistance of a property lawyer.

Understanding and addressing these issues can help ensure the value of your investment is protected and improve the chances of living in a collegial way with your property neighbours.

GET IN TOUCH

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