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Changes to the Bright-line Test

In an attempt to dampen property speculation activities that were perceived to be driving up prices of residential properties, in 2015 Parliament enacted legislation putting in place a "bright-line" test so that if a property is sold within two years of purchase any gain is fully taxable as income. In addition to formalising an effective capital gains tax on short-term property ownership, one of the consequences of this test is added disclosure requirements at the time of all property transactions – meaning increased compliance for everyone who buys or sells property.

Following the election of a new coalition Government in 2017, one of the coalition's promises was to extend the period subject to the bright-line test from 2 years to 5 years. On 29 March 2018 the legislation that would give effect to this policy was passed into law.

Consequently, it is important to understand that from 29 March 2018 (until 28 March 2020) there are now two periods that may apply to transactions:

- For residential properties purchased in the two years up to 28 March 2018, the bright-line test will still apply if the property is sold within two years.
- For agreements to purchase residential property on or after 29 March 2018, the proceeds of sale may be taxable under the bright-line test if the property is sold within five years.

There are exemptions to the bright-line test for the main home, inherited property and property transferred to an executor/ administrator of a deceased estate.

While the intention of Parliament introducing the bright-line test regime was to dampen property speculation, in order to achieve this and to prevent speculators finding ways to get around the rules, certain related party provisions were included in the original legislation. In practice what this means, however, is that complications can arise if properties have been transferred to or from trusts, companies or other close parties during the bright-line period.

It was just such a situation that gave rise to the first court case concerning the effects of selling a property that had been transferred to a family trust, GG & GE Blackburn Trustee Limited v Crowe Horwath (NZ) Limited.

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In this case the transfer had the effect of re-starting the bright-line period for a property that had been owned within the family of a settlor of the trust for some time before the introduction of the bright-line test. When the property was sold Inland Revenue assessed a large tax liability.

This was exacerbated by the use for the purposes of the transfer to the trust of the then current rating valuation, rather than a registered valuation which would likely have been higher. The case itself involved allegations of professional negligence, for which summary judgment was refused by the High Court, where the trustee was seeking compensation for the tax liability it had to pay.

Note also that if the vendor is an off-shore person (this definition is very wide and can capture New Zealand companies with non-resident directors and shareholders and resident trusts with non-resident trustees or beneficiaries) a withholding tax (RLWT) can apply to sales of property subject to the bright-line test.

We recommend that you seek advice regarding whether the bright-line test could apply before entering into any agreement for the sale of residential property or any transfer of residential property, other than the main home, onto trust.

Considerations when updating memoranda of wishes



It is common practice when settling new trusts for the settlor to execute a memorandum or letter of wishes setting out guidance for the trustees as to how the settlor would like the trust's capital and assets to be dealt with in future (especially after the settlor has died). The Issue that has come before

the courts on occasion has been that of how strictly should trustees follow the settlor's wishes? Following recent cases, the attitude of the courts has been that while trustees might give consideration to the settlor's wishes, these must always be secondary to the trust deed.

A further issue concerns updating of memoranda of wishes while a settlor remains alive. It is often said that wills should be regularly reviewed and updated as someone moves through different stages of life and circumstances, whether owing to financial, family, health or other considerations, all of which may change accordingly. Should memoranda of wishes also be updated in a similar manner?

In practice they often are. Moreover, it is not uncommon for the wishes expressed by settlors to vary markedly from previous versions. This can create more, not less, uncertainty if the time comes when the wishes are considered by a court, which is looking at a memorandum of wishes as an indicator of how the terms of a trust deed might be interpreted.

For example, in a recent case, *Goldie v Campbell*, an original memorandum of guidance (i.e. of wishes) referred to the needs of two daughters as "paramount" and having priority over all other beneficiaries. Subsequently, after Mr Campbell and Ms Goldie had separated and Mr Campbell entered a new relationship, he exercised his powers as appointor to add the new partner and her children as beneficiaries and signed a new memorandum of wishes requesting that the new partner and her children be given similar weight in trustee consideration. The High Court upheld an earlier finding that Mr Campbell did not have the power to remove the daughters as beneficiaries, citing the original memorandum of wishes as one factor in interpreting the trust deed.

In *Clement v Lucas* the High Court also considered the effect of an evolution of memoranda of wishes over a period of time, changing circumstances and feuding family members. When the trustees subsequently chose to ignore a more recent memorandum of wishes and to sell land when this was clearly not as wished. The High Court held that when they made a decision, they were advised at the time that they had "a duty to consider the purposes for which [a] Trust was established and the intentions of the Settlers ...". Their failure to do so this amounted to a breach of duty and was set aside by the Court. While it is still understood that the terms of the trust deed must outweigh any expression of wishes that are inconsistent with it, the importance of memoranda of wishes is not to be underestimated.



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What does it mean to be an appointor?

It is common for trust deeds to name a person or persons as appointors with the power to add and, sometimes, remove trustees. But what does it mean to be an appointor? And how does an appointor decide whether or not to add or remove a trustee?



As a general rule a power to appoint trustees is a fiduciary power, which means that the power must be used in the best interests of the beneficiaries, rather than to suit the wishes of the

appointor. When or whether to exercise appointor powers requires the appointor to be aware of who the trustees of a trust are, and whether they are acquitting their responsibilities.

In some circumstances a power of appointment must be exercised – for example where the number of trustees falls below the minimum number specified in the trust deed, due to the death, retirement or removal of a trustee. However, there is an inherent obligation for the appointor to consider exercising the power of appointment from time to time when an appointment is capable of being made. This means that appointors need to know the parameters of their power of appointment and to be sufficiently well informed about the operation of the Trust to know when or if to appoint or remove trustees (as relevant). Generally, this simply means being in a state of preparedness to act if required for the benefit of the beneficiaries. However, it is not possible to be prepared if an appointor is unaware of the appointment or unaware of the goings on of the Trust.

Trust Bill Update

As mentioned in the previous newsletter, the new Government has picked up the Trusts Bill and included it in the Parliamentary legislative programme for this year. The Trusts Bill as proposed not only reflects many of the key aspects of the common law concerning trusts, developed over hundreds of years, but also proposes a number of potentially far-reaching changes.

The Bill is now being considered by a Parliamentary Select Committee and extensive submissions were received from both experts and from the public. The Committee was due to report back to Parliament on 5 June 2018, but this has now been extended by three months to 5 September 2018. Moreover, it has become apparent that there are some strong differences of opinion concerning proposed provisions of the Bill that may not be readily resolved.

Accordingly, and depending on how the Committee reports back to Parliament, it is no longer clear that the Bill will be passed into law before the end of 2018, or indeed whether there may be extensive revisions to the Bill as presently drafted.

While the provisions of the Bill, if enacted, will affect all existing trusts, whether or not individual trust deeds may need to be amended or other actions taken remains unclear. While many trust deeds could clearly be improved and the principles underlying the Trusts Bill provide a useful basis for consideration in the meantime, it cannot be ruled out that further changes to the Bill might need to be taken into account at a later date.

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