Issue Three: Twenty Twenty One

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Covisory Connect

MAGAZINE

About us

[but really all about how we can assist you with your issues and concerns]

Are you looking to understand what is important to you from your perspective?

We partner with you to help you understand what is truly important to you. We help individuals, families, and their businesses to exceed their expectations for what matters most to them.

Have a problem?

We work with you to transform how you conduct your businesses and trusts. We help you to build enduring, resilient systems and capabilities across all that you do.

Our team defines us

Covisory is a team that are united by a strong set of values, with a deep commitment to making a positive impact through our work and how we connect with you, our client.

With an expert team with significant technical and commercial experience based in both New Zealand and Australia, we combine local insight and global expertise and contacts to help you turn your goals into reality.

Our consultants include accountants, lawyers, designers, business managers, entrepreneurs, strategists, researchers, and writers. We can provide you with the right team, with the right expertise and experience when you need it.

All our people have been drawn to Covisory for the opportunity to apply their expertise to important complex challenges that you face.

Our reputation is defined by our interactions with our clients

- We help clients build strong systems to achieve better performance through data.
- We work with you to build positive outcomes for your future, and for future succession.
- We create solutions that are always in partnership with you, that uniquely combine our expertise and the particular resources of your business and family circumstances. We deliver innovative solutions that create immediate results and a strong framework to sustain your progress into the future.

OUR PURPOSE

To be innovative customer-centric advisers exceeding your expectations for your business, trust, wealth & tax needs

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NIGEL SMITH
Founder -
Covisory Group

Introduction

Welcome to our third edition of Covisory Connect for 2021, which this year will be the final edition. With lockdown and an urgent need to change our practice management software, we are only doing one more for the year.

I am writing this in lockdown, Delta level 3.3. If the Government was a business, it would have failed by now and been out of business. We all too often talk about planning for what's ahead, and looking for the opportunities, but to be honest this Government couldn't organise its way out of a brown paper bag.

The vaccine roll out was late, there is no sign of an app and there is certainly no road map. What will happen when we get to 90% vaccinated? I have no idea and I am sure you don't. Hospitals and capacity and particularly ICU beds remain a concern and given that the Government had a lot of notice that Delta was coming, let alone those that will follow that will be even more virulent, the lack of planning and readiness has quite rightly seen us drop from 1st in the OECD standings for preparedness to last.

It is this lack of certainty that does make it difficult as businesses to plan. However, we need to keep asking questions of the Government even if they are not answering them. Are we going to be able to mandate that staff and others have to be vaccinated? There are a whole host of questions that we will need answers to soon so that we can have some understanding of the future because one thing is clear it will be a future with COVID in it, but at a managed level.

This lockdown is going to see a significant impact on businesses post lockdown, and not just in Auckland but in the surrounding areas that rely on spill over tourism and business from Auckland. There may some small sugar rush, but I think Grant Robertson is wrong to think there is going to be a big rebound this time. Certainly the stories and evidence we are seeing is that a lot of businesses have closed and that people generally had less emotional, psychological and financial resources to call upon this time. Interest rates are now also looking like they will head up and that will also dampen the economy. Getting labour is difficult, so even if you have a business, you may not have staff to man it adequately. I was saddened earlier in the year to visit family in the Hawkes Bay see fruit rotting on trees that normally would have been picked.

So 2021 the year was perhaps not what we thought it would be. Dealing firstly with work it has been a steady to quiet year with little or no international work and lots of small enquiries. We have felt a bit like the GPs seeing someone different each hour.

In the wider economy, M&A work is busy, but overall lockdown has seen professional services quiet with very low levels of work, chatter, emails and calls.

For my family the kids have managed remarkably well. Their resilience always impresses me. The school systems have been strained particularly for those children like my son who are doing practical subjects. For my daughter, the university has worked much better with Auckland simply acknowledging that the rest of the year was going to be online. God only knows what will happen with exams, particularly for NCEA.

Personally 2021 has been a mixed year. A highlight was being awarded a fellowship by CAANZ. The lows have been dealing with aging parents and having to put my step mother into a secure dementia unit, and the impact that that has had on the family.

Personally, I have had a lucky year as well having walked away from a very serious car crash when a speeding truck failed to take a corner and cleaned out three cars, of which I was the third. Everyone else involved in the other cars all got a helicopter trip and I walked away completely unhurt. I feel a bit like I have had cancer and survived, more ready to enjoy life and perhaps feeling a little bit luckier than I did before.

We had all hoped that 2021 would be a better year than 2020 but as we get to the end of it it perhaps may even end up being worse. We cannot see that the balance of the year will be significantly different to what we are experiencing at the moment, but what we can do is look forward to 2022 and hoping that we are free again both to do what we want, travel within our country and if you wish to travel overseas again. They key to economic recovery is going to be making sure that businesses can get the finance that they need to improve their productivity and expand. I am not confident that banks have their heads in the right place to lend to businesses because they don't know which ones to support and which ones not to. Watch 2022 to be the growth of the non-bank financial sector. There is going to be a lot of demand for money when the banks say no to finance applications.

2022 will also see the housing market continue to rise, although perhaps not at the same levels we have seen in the past. Supply chain problems are going to see delays and further cost increases, and it is these cost increases that means that all house prices will keep rising if the cost of new stock does as well.

So here is hoping that we do get to have a quiet and relaxing Christmas with family and friends away from where we have been locked down at the places that we look forward to spending time.

May 2022 be better for you, your family and your business. But above all, may you be safe and well.

Nigel Smith

IRD High Wealth Research Project

You need to be aware of this project and the implications.

By now you will have heard that the Labour Government / IRD is proposing to send out letters to 400 selected high wealth individuals and their spouses. It's part of a research project to see how rich the rich are and how much tax they pay.

The section that gives the IRD power to conduct research projects was passed under urgency recently and was not subject to the usual full consultation process.

Clearly, the Labour Government / IRD is looking at either a wealth tax or yet another crack at a capital gains tax. Either way, they are gathering data to make sure that they can accurately forecast the yield or collection from such changes, and to make sure it is properly targeted.

I attach a copy of the IRD forewarning letter that has been sent to the tax agents for the 400 unlucky taxpayers who were randomly selected.

We consider the only good thing about all of this is that the IRD has forewarned the tax agents, who no doubt, like us, will be fielding a lot of calls from soon to be very angry clients.

With Auckland in level 3 lockdown, their timing is incredible to start with. Clearly, no one at the IRD involved in the project has even thought about the mental stress this will cause, or they believe that being rich they can at least afford private counselling, albeit on zoom while locked down.

We are looking at the penalties for telling the IRD to simply piss off. Given the Government's track record for covid breaches that may not be an unreasonable answer. Section 145 of the Tax Administration Act imposes a penalty not exceeding $15,000 for the first offence, and up to $25,000 for second and subsequent offences. One would argue that not complying with the whole project was a single offence, notwithstanding that the IRD intends to send at least 3 letters separately plus the warning letter.

The IRD may also consider that it has the power to force taxpayers to comply under section 17H, again a recently changed section, I do not necessarily agree that the IRD will have the stomach or the resources to pursue large scale non-compliance, let alone individuals who would cost the IRD a lot to pursue one on one. Just ask Bishop Tamaki or those breaching the borders.

So if you are affected or have clients affected be very careful of what you are about to receive and answer.

We live in very very interesting times.

Please feel free to contact us if you are affected by the current IRD project and require assistance to manage it.

- Nigel Smith

[IN CONFIDENCE RELEASE EXTERNAL]

Inland Revenue
Te Tari Taake

Policy and Regulatory Stewardship
Kaupapa me te Tiaki i ngā Ture
PO Box 2198
Wellington 6140
New Zealand

20 October 2021

Tēnā koe,

High-Wealth Individuals Research Project

You have been selected to take part in Inland Revenue's high-wealth individuals research project.

This is a statistical research project that aims to fill a gap in our knowledge of effective tax rates relative to economic measures of income, particularly for high-wealth individuals.

In the next three weeks, we will contact you again to ask for details about your household.

All the information you provide will be kept confidential, and will not be used to reassess your tax liability.

Why are we carrying out this project?

The project seeks to improve the evidence base for making assessments of the fairness of the tax system. The project is not making any policy recommendations, but the analysis will inform future tax policy advice.

The research will be published in a report to be made public in mid-2023. This report will not identify any individual, their financial information or their specific effective tax rate.

How will you be involved in the project?

We have selected about 400 high-wealth individuals to take part in this research project.

The project will use household income as the unit of analysis, so we will ask you for information about your partner (if you have one) and any dependent children.

You and your partner will separately be asked to provide information to Inland Revenue. If you have any dependent children, you will be asked to provide information about them.

What information will you and your partner be required to provide?

In November 2021, we will ask you to provide details of your partner and any dependent children.

In January 2022, we will ask you for information about the various entities and business undertakings (that is, companies and trusts) you, or your dependent children, have an interest in. We will ask your partner for the same information in relation to the entities and business undertakings they have an interest in.

In May 2022, you and your partner will be asked to provide further financial information to hel p us calculate the measures of income for our analysis.

This information is important. Information requested in November, January and May will be sought under section 17GB of the Tax Administration Act 1994. You will be legally required to respond to these information requests.

Confidentiality

We will preserve the privacy and confidentiality of all information we collect from you.

Information collected under section 17GB has specific statutory protections that prevent the Commissioner of Inland Revenue from using it in proceedings against you. We will only use information you provide in response to a section 17GB request for this project. See the enclosed information sheet for more information.

What are you required to do now?

If we have a record of your nominated tax agent for personal income tax, we have noted their email below and informed them that you have been selected to take part in this project.

However, as the project does not relate to your income tax obligations, please confirm which tax agent or representative, if any, you authorise to act for you.

By 29 October 2021, please nominate your tax agent or representative by emailing the enclosed authority form to etrproject@ird.govt.nz or by sending it to the above PO Box (marking it for the attention of Felicity Barker). We would prefer you to nominate only one tax agen t or representative.

If you have not received this letter by email, this means we do not hold a current email address for you. Please provide us with your preferred email address, or amend the address we have for you, by emailing etrproject@ird.govt.nz by 29 October 2021. Please let us know if you do not want your Inland Revenue customer record updated.

In the nex t three weeks, we will send you a link to an online form (by email and/or letter) asking for details of your partner and any dependent children. We will then contact your partner to tell them about this project and ask them to nominate a representative.

Further information

You can find out more about the project in the accompanying information sheet and at www.ird.govt.nz/hwi-research-project. If you have any questions or would like to arrange a phone call to discuss, please email etrproject@ird.govt.nz.

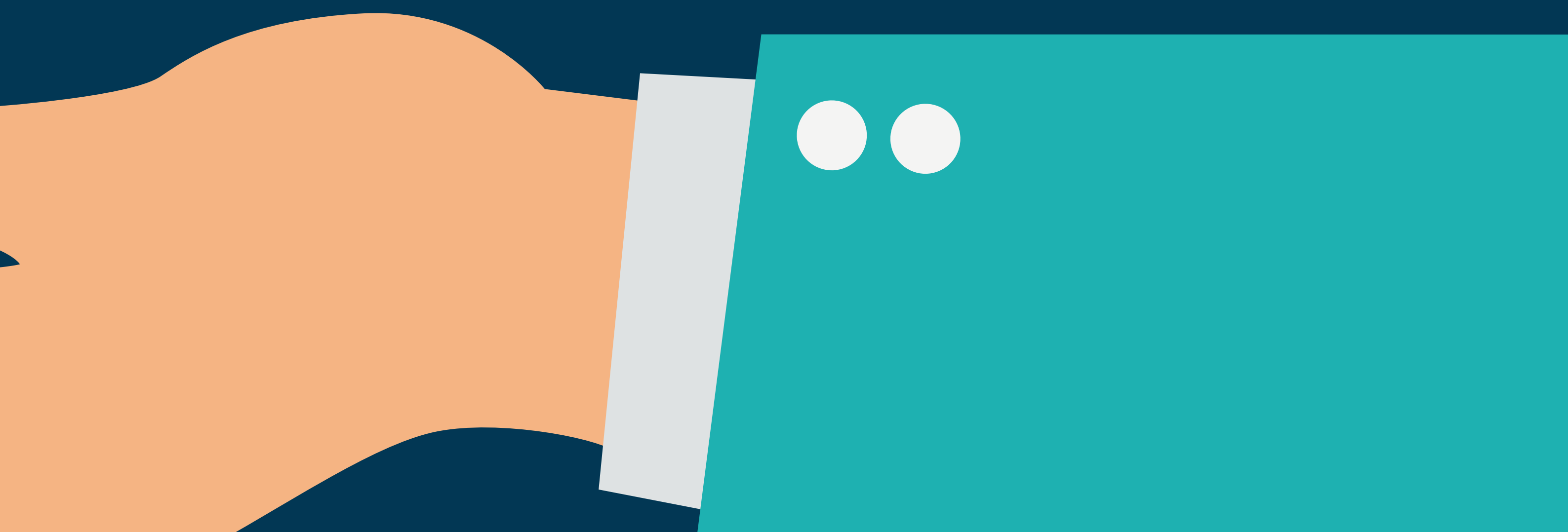
Yours sincerely

David Carrigan
Deputy Commissioner Policy and Regulatory Stewardship

Helping Your Children into Properties

From a trustee’s perspective I want to raise the issue with you of parents helping their children into houses. As trustees, advisers, accountants, lawyers or whatever your role may be we all get involved in these discussions. We also have the same issues in our own families.

So, what are the options that we have when children are trying to buy a house?



Parental involvement is now a relatively frequent approach to first home buying, although some children might still do it on their own, or they might do it with their partner.

Option 1 - Loaning funds

The first option is obviously for the parents either individually or through the trust to loan funds to the child. The problem with this is that some banks will treat that loan as part of the borrowing against the property and take it into account for the LVR ratio. As a result the bank will lend less and the loan from Mum and Dad or the trust doesn't count as part of the equity in the house purchase. This is particularly the case if you deal with some of the smaller banks and some of the secondary financiers. So sometimes Option 1 simply doesn't fly.

Option 2 - Gifting of funds

The second option is that Mum and Dad or the trust can make a gift or a capital distribution to the child or a trust as the case may be. The problem with this is that's all well and good but what happens in the future if that child is in a relationship and that relationship fails. How do you protect for that? The only way that we would allow that to occur would be if there was a relationship property agreement between that child and their partner or spouse acknowledging that that part of the funds represented separate property either as a nominal sum not inflation adjusted or alternatively as a part ownership of the house. It could be done on either basis.

If we were a trustee, we would not allow those funds to be loaned out of the trust or distributed without that relationship property agreement pre-nup being put in place. Now the pre-nup doesn't need to deal with all assets it just needs to deal with those moneys. This is a viable option and we have done that in a number of cases.

Option 3 - Taking an equity stake

The third option is for the trust or Mum and Dad to take an equity stake in the house that will be recorded on the title. You should consider setting up a co-ownership agreement around that for the future. The real problem we now have is that if it is a new build, you will have a 5 year Brightline period for Mum and Dad or the trust or if it's an existing property a 10 year period so that part ownership of the property by Mum and Dad or the trust is going to be subject to the Brightline Rules. Mum and dad can't even gift that part ownership to the child within the Brightline period.

External factors that come into play

The other area you have got to be very careful about is where we have a trust acquiring the property for the child or children and their spouse. The reason for that is the Brightline exemption applies where the home is used by the principal settlor of the trust. The settlor is obviously the person named on the deed as the person putting money in, but under tax law, the settlor can also be persons gifting money to it, the settlor of a trust that distributes money to that trust, or someone even loaning money to that trust. If Mum and Dad have loaned money or distributed money from a trust or personally then of course they may be settlors but if their relative contribution from a settlor settlement viewpoint is more then of course they could be deemed to be the principal settlors and not the children. This is a point you must be very careful about to work around the Brightline rules.

Overall, the biggest concern that I have when I am an advisor or a trustee in this area is to make sure that Mum and Dad can afford to loan those funds or gift those funds to the child. How is it going to impact on Mum and Dad's future? We see this not only in relation to buying a home but kids going into business. Mum and Dad might have the squeeze put on them by the child to make an investment in their business or loan some money to start a business. You have got to assume that that money is not going to come back because that is the worst scenario and if that is the case how will Mum and Dad fare? In some cases, I have seen Mum and Dad's home sold up because a mortgage was taken over it to support a child's business. You have to be very careful particularly if there is a mortgage there if the Mum and Dad are guarantor or the trust, the bank does not have an obligation to necessarily tell you if they are loaning further funds. Be very careful to understand how the banking arrangements work as well.

This is a difficult and emotive area, firstly we have got to decide whether parents can help their children be it directly or through trusts, then we have got to decide how to do it.

Creating family equity

The next hurdle, is how do you maintain an equitable treatment between your children. Johnny or Mary might buy houses many years apart so how are you going to maintain that equity?

Mum and Dad or the trust have helped Johnny into his home and it has worked out well. The problem is a couple of years later Mary and her partner come along and they want financial support as well. How do we maintain equity between children particularly in a market where house prices are increasing? Also how do we recognise differences in income earning abilities of children?

There are a couple of options, but I think the first thing is the rules should be set when the first child is supported, and the rules should be made clear to all family members.

If you are going to do something for one child, you are going to have a good think about being prepared to do it for all of them. Obviously Mum and Dad can decide an arbitrary amount depending on the financial position and needs of a particular child but there should be a limit to it and I think that is what we need to explore. In our mind the easiest way to do it from experience is to benchmark it against a property value. It might be the median house price in Auckland, it might be a house in a particular area. Now you might be expecting that children are just going to buy an entry level house, but we end up having these conversations with children who are looking to buy a $3m or $4m house as their first home with Mum and Dad's support. So be prepared for some big numbers in these conversations. Expectations may need to be managed.

If you are going to benchmark and peg it; obviously you are going to need to have a very clear understanding of what that benchmark is and again how does that apply if one child is in Auckland and the other is in Dunedin. A deposit in Auckland might just about buy you a house in Dunedin or not quite but it is going to go a lot further. Obviously again issues around repayment and relationship property protection that we discussed in Part 1 are relevant.

The only other alternative that I have come across actually came from the Top Gear show that I watched many years ago. A couple of wealthy people in the UK came up with a very interesting comment that has always stuck in the back of mind. What they said is that they would match the savings of a child towards a house however they put a twist on it. For a child who became an accountant or a lawyer and was able to earn great salaries they might get two times the savings matched from Mum and Dad. But for a child that went and pursued a social good a nurse, a teacher, a doctor who might not earn that sort of amount or might have a higher student loan in the case of a doctor, Mum and Dad might match that 4 times the amount saved by the child. Accordingly, there are some different options out there that are worth exploring.

When I sit down with families, I need to understand what works for them. I work from the premise that one size does not fit all and that what works for one family may not work for another. At the heart of any discussion is the fact that Mum and Dad need to be able to afford it and if this is the case then it needs to be equitable across the children.

We have got to balance the sense of entitlement and the social conscience that is being pushed on to parents these days that they must support their children. I don't know about you, but I know I certainly didn't get a lot of support when I bought my first house, and I didn't expect it. It is something that we need to sit down and talk to our clients about and as an advisor or trustee we need to be part of that conversation.

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Tax in Brief

1. The Pitfalls of GST and Land Transactions.

A recent Court of Appeal case (Marr v Mills [2021] NZCA 505) highlights the complexities for a property transaction where a party fails to provide correct GST information.

A vendor was ruled to have breached the warranty relating to her GST registration status in respect of a sale & purchase agreement. The vendor had incorrectly stated that she was not GST registered on the agreement. The purchaser had intended to claim a second-hand goods input tax credit on the purchase based on this information. The District Court found that the purchaser was entitled to damages for the breach of warranty to the amount of the input tax credit.

The High Court confirmed this decision by dismissing the vendor's appeal. The vendor's application for leave to appeal was then declined by the Court of Appeal.

This case confirms the importance of determining the correct GST status of an entity selling property. The relevant GST provisions in the standard Real Estate Institute sale and purchase agreement should be considered prior to signing an agreement rather than being considered prior to settlement.

Even though the purchaser was awarded damages in this case, the time and cost involved with court proceedings makes it sensible for both parties to do the necessary GST due diligence prior to signing a sale and purchase agreement.

2. OECD Tax Deal for the Digital Age

On 8 October 2021, New Zealand was one of 136 countries to agree to an OECD proposal for a global minimum corporate tax rate of 15% from 2023.

The agreement will also seek a fairer distribution of profits by reallocating taxing rights to countries where the business activities occur and earn profits.

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BUSINESS:

Will History Repeat Itself?

What will the economic and business environment be when we emerge from this current lock-down?

I am a great believer in history repeating itself. So, what did we experience when we emerged following our initial Covid-19 lock-down during the first half of 2020?

How did we fare in respect of key economic indicators?

- GDP, the measure of economic growth (or contraction), grew from an annual average growth rate of negative 1.3% for the June 2020 year ended, to 5.1% for the June 2021 year ended

- Getting behind the quarterly GDP numbers tells the real story. In the ¼ of the initial lock-down (1/4 ended June 2020) GDP contracted a whopping 11.0%. Growth in the following quarter was even more spectacular – GDP grew by 13.9% in the ¼ ended September 2020, buoyed by a rebound in business activity and consumer spending. In the next ¼ GDP contracted 1% followed by two ¼'s of more usual growth – 1.6% and 2.8% respectively

- The unemployment rate dropped from 4.1% at June 2020 to 4.0% at June 2021 – a further positive sign for the economy

- On a more sobering note; the annual inflation rate increased from 1.5% to 3.3% and the Current Account Deficit from $4.7bn to $11.2bn (largely due to a marked decline in travel-related revenue).

The strong economic and business performance in the year following the initial lock-down was greatly aided by the buoyant economy going into that lock-down as well as more resilient business performance during the lock-down and in the months following. Rising house prices and low interest rates provided the impetus for much of this economic growth, as did NZ's low (relative to other OECD countries) Government Debt to GDP. Business performance benefitted greatly from household incomes remaining relatively unaffected, due largely to the wage subsidy, and consumers spending their savings during the lock-down.

The big question is, do similar conditions exist today, to give us the confidence that when we emerge from the current lock-down it will be into a strong economic and business environment.

What is the current outlook?

- No doubt GDP will contract for the September 2021 ¼ - economists are expecting a 6 – 7% contraction; around one-half the level that we experienced for the ¼ of the initial lock-down

- A smaller contraction bodes well for a recovery to pre-lock-down levels, provided the stimuli for such growth remain

- As outlined above, the economy was particularly buoyant going into this current lock-down. Further, as businesses have returned we are seeing a re-bound in activity. Household incomes have again been relatively unaffected; again largely due to the wage subsidy, and whilst Government Debt as a percentage of GDP increased from 19.5% pre the initial lock-down to 32.6% at June 2021, this remains particularly low relative to other OECD countries and with significant headroom to absorb the further debt taken on by the Government during the current lock-down

- There are, however, a few clouds emerging;

  - rising house prices and low interest rates, which provided much of the impetus for growth post the initial lock-down, are almost certainly not going to do so this time around, and

  - it is likely that consumers will be more cautious with spending their savings during the current lock-down as they did for the initial lock-down, largely because of the uncertainty surrounding whether lock-downs will be a thing of the past or are here to stay;.

In conclusion, whilst the economic and business environment will be very similar when we emerge from the current lock-down compared with the initial lock-down there are some factors weighing on the economy and business activity which we expect to result in lower economic growth and business activity when we emerge from the current lock-down compared with the initial lock-down.

The silver lining is that this time around the economy contracted at around one-half the level as for the initial lock-down – meaning that any rebound requires to be at a significantly lower rate to return to pre-lock-down levels.

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Update
on the new Brightline rules for residential rental properties

Recently announced were proposals to change the Brightline property rules for residential property. Residential property is anything that is available for long term accommodation. It does now include Airbnb and bookabach type properties, but it doesn't include hotels, motels, all the other things that you would think of as non-residential.

On 27 March 2021 we had a new change come through in the Income Tax Act 2007 section CB6A that changed the five-year Brightline period to a 10 year Brightline period. Any property acquired on or after that date and acquired means basically a binding contract is subject to the 10-year rule unless exempt.

Now the good news is that if you currently go and acquire a new build you will only be subject to the 5 year Brightline period and not the 10. So there is going to be a carve out not only for interest deductibility on the Brightline for new builds but also a halving of the Brightline period from 10 years to 5. In order to get that 5 year period you must acquire the new build no more than 12 months after the CCC for the property is issued and when you sell it the new build must have its CCC by that time. So of course, you could buy a property before it gets its CCC and again on-sell it before it gets its CCC. What is interesting, is that it is forcing the housing stock to have code compliance and that is different to the interest deductibility rules.

Obviously, your main home is exempt but there were also some other changes made. Firstly, if you rent your main home for a couple of years then live in it say for 5 years and then sell it that is obviously less than 10 years. When you come to sell it 2/7ths of that gain would be subject to tax. Previously under the Brightline test it would have been exempt because the house had been primarily and principally used as your residence. That majority test is gone, and it is now an apportionment. Needless to say, if it is a new build the period is 5 years as well, you sell it after that you don't have to worry about the apportionment but otherwise if it is not a new build you will be looking at the 10 year period.

There is also a proposal to change the situation where the main home is also part rented so that the main home portion is smaller than the part that you rent out. In that scenario there will be an apportionment as well. If you rent a bedroom out to a student or someone like that or a boarder that is going to be exempt. But if you rent the majority of your house out then the Brightline test could then apply to you as well.

The other thing that is very good to note about the Brightline changes is one that will make some common sense. Currently if you want to move assets around even those that you have owned pre Brightline you could reset the Brightline period. A very good example of this in the last couple of years has been with trusts that we have wound up because of the new Trusts Act 2019, I am sure you and your clients have as well. So, the reality is the Bach down the Coromandel needs to come out from the trust and we are going to put it back in Mum and Dad's name, probably owned in the family for 30 years and no one thinks about the Brightline test. However, by selling it out of the family trust the Brightline test restarts and if it is post 27 March 2021, it is a 10-year Brightline period. As a result, if you sell that Bach within 10 years it is going to be subject to income tax on the gain in value from 27 March 2021 or whenever you actually transferred it after that date.

There are some proposals and I think these will be tweaked a bit more so don't get too reliant on them, but the general theme is here. There is a proposed roll over relief which is going to allow people to transfer property without triggering the Brightline rule and it will be bifurcated, a two-part test. It means the person transferring it won't necessarily be subject to the Brightline and the person taking it over, if they are associated, will be deemed to have owned it from when the related transferor originally acquired it. This rule would work effectively as CB15 does in the Income Tax Act 2007 now. The problem with CB15 is it doesn't apply to section CB6A, the Brightline provisions. Currently it appears what they are talking about here is some transfers to and from family trusts, look through companies and partnerships. It doesn't look like it is going to extend to companies, but that remains to be seen. Again, this is only proposals and while we have draft law, it is at the financing select committee within parliament and it is likely that we will get some fine tuning of this as submissions are made. You have got to remember that this has been law made without consultation largely so far so there is still a lot of input to be made into it. Any changes will likely apply to transfers on / after 1 April 2022.

The only thing to be very careful of is that while all these other changes for interest and Brightline tests are applicable already post 27 March 2021 the proposal to change rollover relief will not apply until 1 April 2022 onwards. If you have got a property you want to move around, maybe you still do want to wind up the family trust, whatever you do don't move those properties prior to that date or you will not get the benefit of the rollover relief.

The rules are tricky, they are a little bit different to the interest deductibility rules and it is going to be necessary to make sure that we don't get tripped up when swapping between them. We will keep you up to date as we get more news and more refinement of the law going forward.

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TECHNOLOGY:

The next step-
What's ahead?

Advancing technologies have continually transformed the way we live and work, and how we interact with one another. Globalisation, increased automation, digitalisation, and social media all have far-reaching knock-on effects on our economy, the way we work, and our personal lives that we're still only beginning to address today.

While speculating on the future is most often futile, we can safely look ahead a short while to see what we as a society are already working to bring about. In the next few years, we can specifically expect to see changes to the way that we invest, how we live, how we educate ourselves and our kids, and how we relate to technology in our everyday lives.

What's on the horizon for the financial sector?

New Zealand is moving to become a world leader in sustainable investment. While this is partly in line with an ongoing trend toward sustainable and impact investing, the government is likely to become the world's first to engage the power of the private sector in fighting climate change.

A bill that passed its first reading in Parliament in April would require New Zealand's largest financiers to disclose the climate impacts of their business' investments starting in 2023. If it were to become law, it's very likely that it will drive vast amounts of investment out of dirty industries and toward more environmentally friendly businesses. This would make it easier for those cleaner businesses to compete, further helping to drive the private sector toward its goal of reaching carbon-neutrality by 2050. Most importantly, it would work to educate smaller private investors about the climate-impacts of their own investments, creating a greater sense of personal responsibility with regard to the environment.

Continuing ongoing trends, sustainable investment in general is expected to grow rapidly worldwide in the coming years. This doesn't just mean that we can expect businesses to become more environmentally friendly, but also more prosocial. Sustainable investment is about investing to encourage a healthy environment and society, and promote good corporate governance. The practice is a response to climate change in one sense, but it's also about facing down larger societal and economic issues.

Living and working in the future

As industries have increasingly become more digitalised and automated, many of the productive jobs that provided the backbone of the middle class in the 20th century have evaporated. At the same time, multiple recessions, an ongoing trade war between China and the US, and the COVID-19 pandemic have repeatedly put enormous pressure on businesses to keep wages from rising much in the past two decades, even as costs of living have surged—particularly with respect to housing.

The pandemic itself has, ironically, presented a solution for many middle class families. Facing real external pressure to do so for the first time, many businesses allowed employees to work from home during the pandemic. As a result, employers have realised that many roles don't require employees to be physically present every day—or at all. This has led to an explosion of remote-working positions.

Over the next few years, we can expect this to manifest as a trend away from urban and suburban living in general. Remote workers don't need to live near major cities or commercial centres, so they can simply avoid astronomical real estate prices to settle in smaller, more rural areas. That, in turn, is likely to reduce the pressure on real estate prices in and near major cities, bringing them more under control.

Education in the future

Currently, universities in the developed world are producing large numbers of graduates who will never work in the field that they studied. At the same time, businesses can't find enough skilled workers. Simply not enough people are learning the right skills for the jobs that are available. So far, little has been done to address this. What's clear, however, is that the issue will come to a head in the next few years. In New Zealand, as well as in Europe, North America, and Australia, many industries, ranging from from financial advice to medicine are hanging on with an aging workforce that's approaching retirement.

Fresh graduates, realising they aren't a good fit for the job market with the skills they have, often can't afford to go back to school. Older underemployed workers similarly aren't able to change tracks, as they tend to be held back by additional financial burdens. As businesses increasingly feel the pinch of the skills shortage, they'll be forced to take a more active role in creating the skilled workforce they need. Likely, affected businesses will work more closely with governments and universities to promote the skills they need, while also directly working to up- and re-skill workers internally. Still, it's unclear exactly how this issue will be addressed on a larger scale.

Technology in the future

Technology has been integrated into every aspect of our lives in the past two decades. For many of us, primarily younger generations, it's become as or more common to communicate using technology than to talk to someone in person. This, alongside social media, email, and cloud services, has made all of our private and professional communications available 24/7.

The impacts that this has had on our mental health are significant. With the rise of work-from-home in 2020, many people and businesses have begun to push back against this blended always-on availability as a way to manage stress and create space for more traditional and healthy social interaction. Going forward, we can expect a greater emphasis from businesses and the government on protecting our mental health. Specifically, businesses have an interest in managing employee stress levels as a way to improve productivity and reduce healthcare costs. New Zealand as well as governments around the world are increasingly considering regulation to protect children on social media, as negative impacts are becoming clearer.

The future is always in flux

While businesses, governments, and we ourselves are always working to adapt to the new world we live in, things do and will continue to change further. Because of that, it's difficult to tell what kind of future we'll be looking forward to even in just 5 or 10 years. We can, however, expect to see progress on the issues that we're actively working on today.

For us, that means accelerated action on climate change, better investment practices, and far-reaching changes in how and where we live and work.

The next step- What’s ahead?

BUSINESS:

Cyber Security

Cyber Security is becoming an important aspect of the modern world. Cyber attacks are a more common occurrence for both individuals and businesses and guarding the sensitive and private information of your business, employees and customers is a necessity.

It's important to build a strong security system that can protect and defend your network against cyber-borne threats. Cyber attacks are unpredictable and can cause economic and reputational damage to your business. It often involves the theft of corporate and financial information that will significantly disrupt your business and erode the reputation and trust you have created with your customer base.

As a regular practice it is a good idea to identify all your company assets and prioritize items that need protection and ensure you can protect yourself against possible threats that can leave your data exposed and vulnerable.

The concept of cyber security and the management of the risks and solutions can be a complex and confusing topic, however, there are some simple steps you can take in order to protect your database against intrusions.

Set up MFA (multi factor authentication) for all employees across your business:

MFA is the first step to creating a strong identity and access management policy. Setting up an electronic authentication method for all employees with access to your database will ensure users are only granted access to websites or applications after providing two or more pieces of evidence to an authentication mechanism. MFA is particularly effective as even if your passwords or logins were breached, unauthorized personal would not be able to gain access without firstly approving the login via the authentication mechanism, which would usually be set up on a personal mobile device.

Creating a password management policy:

Set up a policy across your business to regularly update your passwords, ensuring that they are well encrypted and difficult to guess. The downside to this is that it can become difficult to keep track of or remember your passwords. Storing passwords on your devices or enabling autofill on your browser can make it easy for cyber attackers to compromise your logins. Password management software is a great product for this purpose, it encrypts your password and stores them safely in a vault online so they can be accessed by your work database but difficult for cyber attackers to decrypt. This paired up with a multi factor authentication will ensure that your websites and applications are hard to breach, and your password and logins are secured.

Setting up a Cloud Security Service:

We also suggest setting up a cloud security service. This is similar to a network security product, however, while network security products focus solely on protecting networks, cloud security protects networks, servers, apps and much more. Setting up this kind of protection service can often lead to lengthy and confusing conversation with your IT team which can discourage businesses from undertaking this project. A simple way to set this up is to have it done at an internet provider level. New developments in Cloud Security products have simplified its set up and management system to create an easy to use and non-intrusive product that works alongside your internet, to provide several layers of security. Setup can be as easy as establishing network and app usage policies at the same time as activating your internet and the system will run it without further attention needed.

It will then inspect your web traffic to enforce established network policies and protect against malware, phishing, and advances threats. These systems often have interactive threat intelligence, meaning they have insight on IP's, URL's and domains that could potentially be malicious and bring them to your attention so you can investigate and respond to these incidents much faster.

It will also provide a report on cloud applications in use across your organization. This will allow you to view details on risk levels and subsequently block and control usage to better manage cloud adoption and reduce risk. The report will also assist you in detecting compromised systems and protecting your users, on and off the network, by identifying and taking action against pending threats.

While the above steps are some generalized security solutions, each individual business may have different security needs and its important to take some time to discuss these needs with your IT team and ensure you have a strong security system in place. With the advancement of cyber attacks, there are also advancements in cyber security and solutions, aimed at making the online world safer.

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Interest Deductibility on Residential Property

Do you have any?

The new law came into effect on 1 October so we would have expected law by now but in a very Australian like move we have only got draft legislation introduced as a supplementary order paper to a Bill already before parliament, and some information sheets.

To start with obviously from 1 October interest deductions will be phased out progressively through to the end of the 2025 tax year for existing residential properties. For properties acquired after 27 March 2021 interest deductions will not be available unless it is a "New Build". That also means that if you top up existing mortgages post 27 March 2021 interest is not going to be deductible. These changes apply to residential property; in brief that is a property which is suitable for people to live in long term. The main home is not caught because of course that is exempt anyway but there are some interesting new twists on that and obviously commercial property unrelated to the provision of accommodation isn't affected by these proposals.

Let us start from the perspective of what is/ not residential property and caught / exempt.

- It can include bare land so just be warned.
- the main home is exempt unless owned by a company. Take care with trusts given the principal settlor requirement, especially when parents have assisted children into a home
- Farm land isn't unless zoned residential
- Emergency, transitional and council housing whether owned by a government authority or even private enterprise is exempt.
- Commercial accommodation such as hotels, motels, hostels are exempt
- Short term accommodation provided in a residential dwelling, AirBnB, BookaBach are not exempt.
- Care facilities, hospitals, nursing homes, hospices, convalescent homes, are exempt.
- Retirement villages and rest homes, employer accommodations, student accommodation and most interestingly land outside of New Zealand are exempt.

Remember these rules are designed to free up supposedly housing in New Zealand so no use denying deductions overseas.

There is an interesting exclusion for certain organisations where residential rentals and land aren't their core business and form less than 50% of their assets. This exclusion looks generous, but it doesn't apply to closely held companies. So that is going to be most of our clients. Closely held companies are companies with 5 or fewer natural persons owning 50% or more of the shares

The interest that is denied as a deduction may be available as a deduction when you sell the property if the gains are taxable up to the amount of the gain. Property developers won't specifically be exempted from the rules, but it is proposed that their development activity will be. So nothing really changes for them, particularly when they are dealing with new properties anyway. If they do retain property to rent residentially then there would likely be the ability to claim the new build exemption anyway.

Let's look at what is a new build?

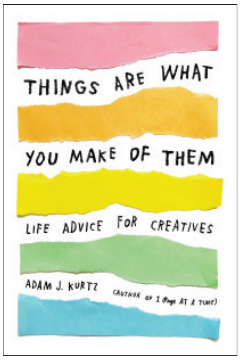
Basically, something that gets a new CCC (Code of Compliance Certificate) issued by the relevant council. The exemption that is going to apply, will apply for 20 years to any owner of the property who buys a property on or after 27 March 2020 where the CCC is issued on or after 27 March 2020. Note I said 2020 not 2021. Quite an interesting slip there, I don't know if that is going to be corrected but at the current time the Government is saying 2020 not 2021 which I find somewhat surprising.

A new build can include modular and relocated houses and it is possible to convert an existing dwelling into multiple new dwellings and this will qualify as a new build. So too can a commercial building that is converted into residential. In brief anything that basically gets a new CCC as a residential dwelling will be eligible for the new build 20-year exemption. What this means is if you buy it and own it within that 20-year window, no matter how many people before you, interest will be fully deductible subject up to the point of the income because of the rental loss limitation rules applying as well. When buying residential rentals therefore look at when it had its CCC issued.

These are only proposed changes and the concern here is that it is going to sit as a Bill and a supplementary order paper with the finance and expenditure select committee for probably 6-8 weeks and maybe a bit longer with the COVID lockdown at the moment. So the reality is that these rules likely will get fine tuned further. My advice to you is just be careful and make sure you check back each time with the relevant law and particularly at least the information sheets in the meanwhile. It is important that you check because there are some confusing points particularly when you line up the interest deductibility provisions against the changes to Brightline rules.

In my opinion not having the definitive law in place is poor governance. The prospect of tinkering what is proposed will also lead to traps for the unwary but at least there is now some understanding of what is happening.

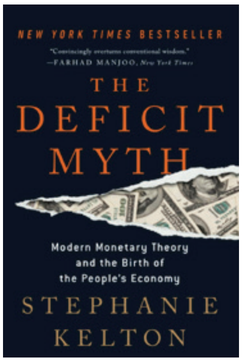
What we have been reading during lockdown?



Things are what you make of them – Life Advice for Creatives. Adam J. Kurtz

I chose this one as I follow Adam Kurtz and have read his book Steal Like an Artist. His style mixes visual art with words to communicate his message. The book is short and really a pep talk served in bite size segments aimed at creatives. It's funny, straight forward and ultimately encouraging.

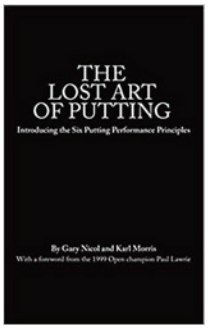
Sally Herbert

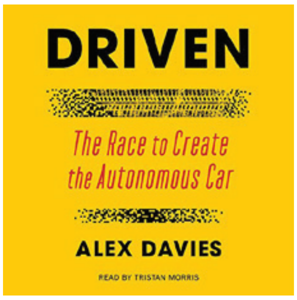


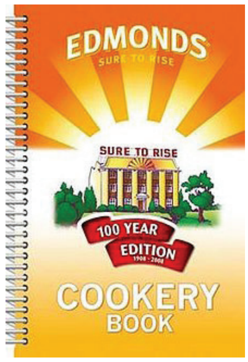
The Deficit Myth. Stephanie Kelton

Completely disagree with the writer's politics and conclusions but made me think and I learnt a bit about economics in a quantitative easing world.

Colin Davies







“The lost art of playing Golf” and “The lost art of Putting” - by Gary Nicol and Karl Morris

As you will all know, I am a tragic golfer. I am addicted to it and I love it. I love tinkering and I love reading. So when these two books came along I was intrigued by them. They are both an easy read and well worth having a look at. They don’t follow the prescription of having a technically perfect swing but rather trying to get your swing to give you the shot that you need in the circumstance and understanding how to shape shots for iron shots and in a similar vein how to read greens and clear your head to be a better putter.

It might not make you play better, but you would certainly enjoy reading them.

Nigel Smith

Driven: The Race to create the autonomous car – Alex Davies

This book was a gift and turned out to be a real treasure. Technically not difficult to read, and an interesting story about the lack of progress to date in creating driverless cars that we were all told would be the future of the civilised world. It is an interesting history of the players, including Uber and Google, let alone the car companies, the efforts they have made and why they cannot solve the problem of creating an autonomous vehicle.

Nigel Smith

From Chris Ng … Ive been reading The Edmonds Cookbook

Need we say more as that literally sums up this lockdown….

Insuring your art

Getting your art valued for insurance is one of those jobs that people know they should get around to doing but often put off because they don't know where or how to start the process. They may wonder if the work they own is even worth insuring or may be less concerned about the value but more about having a complete inventory of the collection. A valuation for insurance will cover all of these areas and will also give peace of mind for the client that their collection is adequately documented and financially covered should it be damaged or stolen.

WHAT IS A VALUE FOR INSURANCE?

This is the valuation that is required by insurance companies for inclusion on a standard household policy. The value determined by the valuer is based on the cost, including GST to either replace the item with a similar item or the cost to have that item manufactured in the current retail market. This sum considers the object's scarcity, quality, provenance, and condition. If the artist is represented by a dealer gallery, then the insurance valuation is usually determined after consultation with the gallery. If the main outlet for the artist's work is through auction, then the insurance valuation is based on an auction value with a premium applied to cover market fluctuations.

An insurance valuation differs from a market valuation which provides a realisable sale value and is based on what the piece would make if it were to be sold in the open market. Sometimes an insurance valuation can be at least double a market valuation so it's important for the client to be specific about what purpose they require the valuation for. An insurance valuation should never be used to divide family assets or for matrimonial property for example and there is a specific methodology for ascertaining values for these circumstances.

Sculpture is a medium that can often have quite a large variance between an insurance and a market value. The production cost of the work can be very high plus there are additional costs such as moving the work and specialist installation as well as an artist fee which all need to be factored into an insurance value. However, if the work was to be sold through auction, many of these costs would not be accounted for. Likewise, a commissioned portrait could cost upwards of $20,000 to account for the bespoke nature of the work, the numerous sittings and time incurred by the artist, however as the work is so personal and specific to the commissioner, it may realise very little if sold on the secondary market.

As art is recommended as a long-term investment, we recommend revisiting your valuation every five years to ensure the values are accurate however as we are constantly monitoring the market and aware of any fast-moving trends and can always adjust values accordingly. Sometimes values need to be revised downward to ensure you are not paying an unnecessary premium. For example, if you had put together a collection of colonial art in the 1970s and 1980s you may find that the values for the works now are less than what had been paid at the time even taking inflation into account.

Some of the most interesting insurance valuations we have undertaken are for public institutions or collectors who acquired works decades ago through personal connections with the artists and dealer galleries. These collections often contain work that is more challenging to value as there are very few market precedents with which to base a value on. Institutional collections contain works which

Installation view of Wayne Youle's exhibition 'Elevation' as {Suite} gallery in August 2020. Image courtesy of the artist and {Suite}.

define New Zealand art history, or the best and most significant examples of the artist's works of which there are no other versions in private hands. How do you value Rita Angus's Cass in the Christchurch Art Gallery, voted the nation's greatest painting in 2006 or William Hodge's A View in Dusky Bay 1773, one of the earliest paintings of a Maori person in New Zealand housed in Auckland Art Gallery, Toi o Tamaki? These valuations combine a number of factors to determine a value of the work including market-based analysis, consultation with other knowledgeable dealers, personal knowledge of off-market transactions as well as an element of 'gut feel'.

Over the years of providing insurance valuations for clients we have been privileged to see a huge variety of art ranging from highly valuable and rare pieces to treasured family heirlooms with lesser commercial value. Our clients have peace of mind knowing that their work has been correctly assessed and documented and are secure in the knowledge that they have a record for future generations as well.

Briar Williams | 027 345 6765
Art Valuations NZ
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The Trusts Act 2019 - Disclosure to Beneficiaries

The new trust laws in New Zealand came into law January 2021 bringing with it significant changes to how you and your fellow trustees will need to administer trusts.

With the financial statements of trusts for the 2020-21 year now being finalised and ready for signing the significance of the new laws will need to be complied with.

Have you told your beneficiaries that they are in fact beneficiaries of a Trust? As a trustee under section 51 of the Act you have a positive duty to inform all beneficiaries of the trust that they are beneficiaries.

You have had sufficient time to work through the options if this disclosure was not the intention of the Trust so we are assuming that you have or will be notifying your beneficiaries as the trust financials come available.

It's now down to the Administration

1. Which trustee will be ensuring that the disclosure requirements are complied with?
2. Have you established who are the beneficiaries – we know it might seem like a dumb question but for some trusts establishing who is a beneficiary is not straight forward?
3. Have you contact details and KYC for the beneficiaries – full name, address, email, phone number
4. What information do you need to provide the beneficiaries?
5. How will you track
    a. What information has been provided and when?
    b. That information has been received by the beneficiary

The administration of your trust will be increased as this is not a one-off situation but one that will be ongoing. We have included a letter template to provide you with an example.

As always, the Covisory team are happy to discuss any questions you have.

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Covisory

[insert address]

Subject: ABC Trust

I am writing to you in my capacity as a trustee of the XYZ Trust ("the Trust").

New Zealand has introduced a new law regarding the administration of trusts, the Trusts Act 2019 ("the Act"). Under section 51 of the Act trustees of trusts are required to inform beneficiaries that they are a beneficiary of a trust and this is the purpose of this letter. We can confirm you are a discretionary beneficiary of the Trust, which is a discretionary trust. A discretionary beneficiary is a beneficiary that has an expectation they may benefit from the trust in the future, but no guarantee that they will.

The names and contact details of the trustees of the Trust are as follows:

[insert names and contact details]

We will also inform you if any of the trustees change through retirement, removal or an additional appointment.

Under section 51 of the Act you also have a right to request a copy of the terms of the trust or trust information. To comply with this we have attached to this letter a copy of the deed of trust and the latest set of financial statements of the Trust.

We hope this is clear. If you require any clarification or have any questions please contact us.

With kind regards
Covisory Trust Services Ltd

covisory.com

TAXATION, BUSINESS,
ACCOUNTING, TRUST'S, AML

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