

Welcome to the Summer issue of *Property Speaking*. This edition is full of articles that we hope are both interesting and useful.

If you would like to talk further about any of the topics covered in this newsletter, please don't hesitate to contact us – our details are above.

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Look Through Companies

How do they work?

From 1 April 2011 Loss Attributing Qualifying Companies (LAQCs) ceased to exist. The replacement loss attributing entity is a Look Through Company (LTC). Here we give some guidance as to how they work and some of the risks.

An LTC is a New Zealand company with look-through income tax treatment. LTC shareholders become liable for income tax on the LTC's profits, whilst also being able to offset the LTC's losses against their other income, subject to the loss limitation rules. Shareholders are treated as holding the LTC's property in proportion to their shareholding. Therefore their liability for the company's income tax, and their ability to offset the company's losses against their personal income tax, are both in direct proportion to their LTC shareholding.

LTC structure The company must be resident in New Zealand, and have no more than five shareholders (look-through counted owners). Only a natural person, trustee or another LTC can hold shares in an LTC. All the shares must be of the same class, and give the same rights and obligations to each shareholder. The look-through counted owner test determines the number of shareholders the company has for the purposes of the LTC rules. Related shareholders, for example, are counted as one shareholder.

How to become an LTC The company director/s and all the shareholders must elect to make the company an LTC by completing a look-through company election form. The timing of the election is important; the date of election must be before the start of the income year. It will remain an LTC until either it no longer meets the eligibility criteria, or the election is revoked.

Loss rules Each shareholder can deduct their share of the company's loss incurred against their personal income, subject to the loss limitation rule. The loss limitation rule is that the deduction a shareholder can use is limited to that shareholder's contribution to the company. This rule ensures that shareholders can only offset tax losses up to the amount of their actual economic losses. Any contribution of \$10,000 or more made by the shareholder within 60 days of the end of the LTC's income year will not be included in the shareholder's contribution to the company.

If the shareholder's share of the LTC's losses exceed their net contribution to the company, the loss can't be claimed by the shareholder in that year. The unclaimed losses can, however, be carried forward to be deducted from income or loss in future years (subject to the loss limitation rule in those future years).

If the company ceases to be an LTC but carries on business as an ordinary company, any losses carried forward by a shareholder due to the loss limitation rules may continue to be used, but only against any future dividends they receive from the company.

Profits Each shareholder will be liable for the income tax payable on their share of the company's net income at their personal tax rate. Whether this creates an increase or decrease of income tax liability for the shareholder will depend on the shareholder's personal tax rate.

Risks When a company becomes an LTC, losses from all prior income years are written off. When a company ceases to be an LTC the shareholders are deemed to have disposed of all of the property owned by the company. When a shareholder sells their shares in an LTC that shareholder is deemed to have disposed of their share of the property owned by the company. Both deemed disposals are at the market value at the date of exit (regardless of actual consideration paid), and the shareholder/s will bear the tax consequences of disposal. This can have significant financial implications. (There are thresholds and exceptions to this rule.)

There may be tax avoidance issues if a shareholder lives in a property owned by LTC (whether temporarily or otherwise), and there are anti-avoidance provisions to prevent excessive use of the LTC structure.

Conclusion Compared with an LAQC, an LTC is a technical and difficult entity to use. Before deciding to establish an LTC, talk with all your professional advisers (us, your accountant and tax adviser) to ensure this is the right step for you and your particular circumstances. ■

Proposed Earthquake Strengthening Requirements

Raises the bar for potential investors in commercial buildings

New Zealand cities and towns typically include many older style commercial buildings, which have long been popular with property investors. In the wake of likely new building standards to be imposed following the Christchurch earthquakes, we consider some of the issues to help you make a wise investment.

The catastrophic collapse of buildings in the Christchurch earthquakes triggered a Commission of Inquiry into why these collapses occurred. Following the release of the Commission's recommendations, the government proposes to amend the Building Act 2004 to provide for nationwide compulsory earthquake strengthening of all commercial buildings. This will have far-reaching consequences for building owners and tenants, and could potentially alter the appearance of our towns and cities everywhere. Assuming that the government's proposals will become law, we set out below some key points.

Assessment

Every local authority will be required to assess all non-residential and multi-storey residential buildings for earthquake weakness within five years of the law coming into force. Priority will be given to buildings with likely falling hazards or on main transport routes. All buildings deemed earthquake-prone will be recorded on a public register. Owners of earthquake-prone buildings will then have 15 years to either strengthen or demolish the building. It appears that owners of listed heritage buildings will still need to comply with the strengthening requirements but they may be able to seek an extension of time in which to comply.

The 33% threshold

An earthquake-prone building is one that is 33% or less of the strength of a building designed to the new building standard. The standard varies for every building, depending on its use and location. To avoid demolition, earthquake-prone buildings must be strengthened to at least 34% of the applicable new building standard. Owners must also bear in mind, however, that many insurers may require strengthening to as much as 67% of the new building standard otherwise owners may face extreme premium increases or no replacement insurance cover. Strengthening will likely involve significant engineering and construction expense. Buildings may also have to be upgraded to meet current fire safety requirements and possibly even disability access requirements. There may also be building heritage factors to consider. The cost implications of strengthening works are therefore huge.

OSH factors

Marketability is another issue. Both owners and tenants must comply with occupational health and safety (OSH) legislation to ensure that their employees and patrons are safe. Landlords and tenants have a personal responsibility to identify all possible causes of harm and take steps to reduce those risks. Tenants may therefore require owners to strengthen to higher standards and within tighter timelines than the law requires.

Undertake good due diligence

Anyone considering purchasing, leasing or occupying commercial property must be aware of the likely upcoming requirements. A detailed investigation of the building should be undertaken at the due diligence stage for buying or leasing so that any strengthening works are known. The degree of works required will undoubtedly have an impact on the building's value, insurability and the bank's willingness to lend.

Commercial leases

Leases need specific clauses to deal with earthquake strengthening issues. These clauses may include who will undertake the works and when, rights of access to carry out works and rent concessions during the works period. Tenants need to consider whether their business can operate during strengthening. Owners and tenants should agree from the outset the percentage to which the owner will strengthen the building as it may have a direct effect on the tenant's operating expenses, particularly in relation to payment of insurance premiums. It may also impact on a tenant's ability to attract and retain key staff. Any contribution from the tenant to the cost of works must be negotiated before the start of the lease. Owners may also want to reserve the right to terminate the lease should they consider the cost of works un-economic. Purchase agreements also require specialist clauses to protect buyers.

These proposed new provisions are far-reaching and will have considerable impact on any property investments. As buyers, owners and tenants, it's vital that you get specialist advice before you sign any agreement for sale and purchase, or sign any commercial property leases. ■

Property Briefs

KiwiSaver deposit subsidy

From 1 October 2013 new regional house price caps, income caps and an additional deposit requirement came into effect in relation to the KiwiSaver deposit subsidy.

The changes are intended to support first-home buyers in the more expensive areas such as Auckland, Wellington, Christchurch and Queenstown, with house price caps increasing significantly, as follows:

- » Auckland – \$485,000
- » Wellington City and Queenstown Lakes District – \$425,000
- » Christchurch City and Selwyn District – \$400,000
- » Thames/Coromandel, Tauranga City, Western Bay of Plenty, Hamilton City, Kapiti Coast, Porirua City, Hutt City, Upper Hutt, Tasman/Nelson and Waimakariri – \$350,000
- » Rest of New Zealand – \$300,000

In line with those increases, the changes to the income cap will make more couples and families eligible than before:

- » For one borrower they can earn \$80,000 or less (before tax) in the last 12 months OR
- » For two borrowers/buyers (or several buyers) they can earn a combined income of \$120,000 or less (before tax) in the last 12 months.

The deposit requirement for KiwiSaver is that applicants must have a minimum of 10% of the purchase price. This deposit could include the money they can withdraw through the KiwiSaver savings withdrawal feature, the deposit subsidy amount they may be eligible for and any other suitable funds, such as savings, fixed and term deposits or funds already paid to a real estate agent. The deposit can also be gifted by a relative.

Buyers using their KiwiSaver facility need to be aware of the strict time frames regarding processing and the requirement of specific documentation to be provided to Housing New Zealand. One standard condition is that the buyer's lawyer must provide confirmation of an unconditional agreement. Time restrictions mean that the KiwiSaver deposit subsidy cannot always be used as the deposit on the purchase price, which is generally paid to the agent when the agreement becomes unconditional. If the buyer intends to use their KiwiSaver contribution to pay the deposit, then the deposit clause in the agreement for sale and purchase must be amended to provide for either a fixed sum (being the amount they do have available without the KiwiSaver contribution) or, alternatively, making the deposit payable on receipt of the buyer's KiwiSaver contribution

Therefore, when a buyer wants to withdraw their KiwiSaver Deposit Subsidy to complete a purchase, they should quickly make contact with their lawyer. To find out more on the deposit subsidy go to www.hnzc.co.nz/kiwisaver ■

Land Covenants

If you are buying a section in a subdivision, it's more than likely the property will have registered land covenants. Land covenants are restrictions registered over a parcel of land and will be noted on the property's certificate of title. These restrictions will bind all future landowners by placing limits and restrictions on what a landowner can do on their land.

Land covenants are typically registered when a landowner subdivides a parcel of land. Landowners commonly want to place restrictions on the use of land when they decide to sell it, particularly if they are retaining some neighbouring land.

The purpose of many restrictive covenants is to help maintain the long-term amenity values of a subdivision and to keep close ties with the Resource Management Act which aims to promote the sustainable management of natural and physical resources.

Typically a land covenant will contain restrictions on how a property may be developed, and include provisions such as specifying building materials which must be used, specifying the colour and shape and size of buildings, requiring building designs to be submitted to a building committee for approval, as well as containing restrictions against further subdivision, or increases in height or increases in density.

If you are buying a section (or any property for that matter) you should be aware that some covenants contain what are called liquidated damages provisions. These provisions can provide penalties which, for example, if you build your house with material restricted by the land covenant, you could be immediately obliged to pay tens of thousands of dollars to your neighbours.

If there is a land covenant registered over the land you are considering buying, it's essential that you fully understand the nature and effect of the restrictions contained in the covenant – we can help you with this. ■