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Most topical at the moment, it seems, is the effect that the new lending rules in the Credit Contracts and Consumer Finance Act (CCCFA) is having on the housing market. These rules impose strict obligations on lenders to assess the suitability and affordability of credit for borrowers. Reportedly, volumes of lending have plunged since the new rules came into effect.

Also topical is the insurance sector's response to directors' liability claims, resulting in large hikes in the cost of insurance and, worse, exclusions for insolvency events (meaning claims based on trading in a period of insolvency are not covered). Aside from that, it appears to be business as usual for everyone other than politicians making their way to and from Parliament across the lawn outside the Beehive.

Tax Protection for Main Home in a Trust

Is your home exempt from the bright-line test where it is held in a family trust? Generally, the answer is 'yes', but some care is required to achieve that result. This article discusses points to watch out for in the case of trust ownership of the home.

First of all you must be a beneficiary of the trust. While that will normally be the case, there are instances where you might not have structured your trust that way, and instead appointed your children as sole beneficiaries. Alternatively, you might have established mirror trust arrangements to own the home. Exemption from the bright-line test is not available where that is the case - but if ownership of the home has been held in mirror trusts for over 10 years (or any applicable shorter bright-line period) this will not matter anyway.

Complications can arise from the fact that only one property may qualify for the main home exemption. Thus, a trust owned property will not be exempt from the bright-line test if you (as principal settlor of the trust) have a main home in your own name or in another trust. An example where this situation might arise is where you assist an adult child into his or her own home and you do so by establishing a trust to own the property. Inevitably you will be the 'principal settlor' of that trust and because you already have a main home, the home owned by the trust and used by your adult son or daughter will not qualify for exemption from the bright-line test.

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This result can easily be overcome, however. You could overcome it by advancing funds directly to your adult son or daughter for him or her to either acquire the property in his or her own name or do so in his or her own trust.

A final word of caution is that the main home exemption will not be available to anyone who has previously used the main home exemption twice or more within the last 2 years of sale of the property or who has engaged in a regular pattern of acquiring and disposing of main homes.

Company Rescue Packages

There are four forms of potential rescue packages available to companies that become over-burdened by debt. A fifth, the debt hibernation scheme that the Government included in its 2020 business support initiatives, expired late last year.

The forms of rescue packages are compromises with creditors, voluntary administration, approved hive downs and formal schemes of arrangement. I do not discuss schemes of arrangement, for the reason that they require court approval and that fact alone limits their suitability as a rescue mechanism for excessively indebted companies, where survival is often predicated on a speedy solution. In my experience, schemes of arrangement are more often used in a takeover setting or a reconstruction of shares to reflect a planned reorganisation of business divisions. I have not seen them used to effect a debt compromise solution, though their scope certainly permits that.

Perhaps the most commonly used form of rescue package is a formal creditors compromise. Where a compromise is achieved, all creditors are bound by its terms and the company is protected against an individual creditor (or group of creditors) taking debt recovery steps against it. This result can be achieved relatively simply and without any need for court approval.

To be successful, creditors must of course be convinced of the merits of the proposal. Inevitably, in the minds of creditors this precipitates consideration of whether there is merit in a liquidator investigating potential claims against directors. It also necessitates that creditors are convinced of the steps to be taken to restore the company's fortunes. Inevitably, this demands an offer to inject fresh capital into the company as the persuasive element in order to gain creditor support. The need to offer a cash injection will be greater wherever there are potential claims against directors made by a liquidator.

In practice, essential to the success of a creditors compromise is a high degree of transparency as between the management team and the creditors. This in turn demands that the creditors are a small group who are well known to the directors or management team, thereby enabling the merits of the compromise proposal to be openly and frankly discussed with them in advance.

The process for implementing a compromise proposal is relatively straight forward. The usual course is for the Board to put together a proposal (either an offer to repay creditors so many cents in the dollar, or seek a moratorium, or both) and send it to all creditors together with a statement of the amount owing to each creditor, their voting entitlement and the reasonably foreseeable consequences for creditors if the proposal is approved. The proposal will be approved if passed by a majority in number representing 75% in value of the creditors, by class. Related shareholders, where owed monies by the company, should be treated as a separate class from other creditors.

No moratorium is available unless and until the proposal is approved. This factor may deter companies from pursuing a formal creditors compromise and instead create a preference for a voluntary administration. This course offers the advantage of gaining a moratorium until such time as a deed of company arrangement (DOCA) is put to creditors for approval. Again, the approval threshold for a DOCA is a majority in number representing 75% in value of the creditors or class of creditors voting.

Lastly, a less often used procedure is a hive down approved by the court under certain 'phoenix company' provisions in the Companies Act.

A phoenix company is a newly formed company that acquires the business of a company in liquidation, including taking its trading name. Arrangements of this type are restricted under company law in order to protect creditors of the 'old company'. Nonetheless, they are permitted with court approval (essentially requiring fair value to be paid to the old company). For example, a hive down might be suitable where a company operates three stores profitably and wishes to close down another two stores that have ceased to be profitable.

Acquiring Company Minority Interests

A key consideration when acquiring a minority interest in a privately owned company is how your exit from the company is to be managed. Pre-emptive rights, tag and drag along provisions and repurchase arrangements (by which either the company or a key shareholder has the right to and/or is obliged to purchase your shares) generally apply to your exit, in one form or another.

Nonetheless, it is not uncommon for investors having to take the lead to secure a buyer for their shares when it is time for them to depart. Commercial realities will often leave the investor hamstrung. Prospective

buyers will demand information about the company to assist their investment decision. How might an exiting shareholder deliver that information?

The ability to deliver that information to a prospective buyer is an important piece of the exiting shareholder's own arrangements at the time of investing in the company. That is because the exiting shareholder will often be reliant upon the support of the Board and/or management team in order to supply company information to a prospective buyer. Without that approval the exiting shareholder will only be able to deliver up information received by the exiting shareholder in the capacity as shareholder (and that information will be limited and/or out of date and often unsatisfactory to a prospective buyer).

There is often no natural reason why the Board or management team would be motivated to lend their support. Moreover, their ability to do so may be curtailed by confidentiality obligations (company information belongs to the company, is subject to confidence, and cannot be freely bandied around) and the objective of achieving a sale of the exiting shareholder's shares might (and often will) run counter to the board/management team's own capital raising initiatives.

Consequently, whenever contemplating investment in a privately owned company, it is recommended you turn your mind to the process that will be involved in ultimately realising that investment. Where a repurchase right is obtained, under a put option or similar, all is well. If not, then reliance on management support to answer a prospective buyer's due diligence enquires will be needed. You should ensure that the terms of your investment provide for that in a suitably scripted subscription agreement.

Memorandum of Wishes to Trustees

Is a memorandum of wishes given by a settlor of a trust effective only where those wishes are given at the time the trust is established? Or will a settlor's wishes also be effective if given to the trustees subsequently?

A recent decision of the Court of Appeal provides the answer. A statement of wishes given after the trust is established suggests that a settlor continues to have control over the trust property. But that is not so; a settlor ceases to have an interest in the property once it is settled on the trust and control over that property lies solely with the trustees.

Nonetheless, the Court of Appeal has ruled that the views of a settlor made subsequent to establishment of a trust are equally applicable as any earlier expressed views and override those earlier views where there is inconsistency between them.

Another issue resolved by the Court of Appeal was whether trustees of a trust ought to balance up distributions to a beneficiary of a trust, for distributions made to another beneficiary from a related trust. It is not uncommon of course for a family to have multiple trusts, essentially special purpose trusts for the home, separate from the business and share investments and so forth. Where say the eldest child receives an amount from one trust, should the trustees of a second trust balance things up by way of a distribution to a younger child (or the younger children)?

Making up for imbalances in these circumstances essentially treats the assets of the respective trusts as a combined pool. It is a mistake to do so. Consequently, the Court ruled that the trustees were not required to take into account distributions from or entitlements under another trust. Nevertheless it is permissible for trustees to do so.

Employee Share Schemes on the Rise

Recent months have witnessed a surge in popularity for schemes that deliver employee share benefits. No doubt there is a variety of reasons for resurgent popularity in employee share schemes. Their relative simplicity may be one reason. A buoyant job market is likely another, as companies are forced to take positive and emphatic steps to retain their high performing executives. Employee share schemes are particularly attractive for some businesses in such a challenging environment, as they invariably widen a company's capital base whilst locking in key employees.

Over the years, the design of employee share schemes has frequently evolved in response to changes in tax rules. Historically, the biggest shift in the design of employee share schemes followed removal of the intercompany dividend exemption in the early 1990's. Removal of that exemption brought to an end the use of employee unit trusts (EUTs) by which tax free dividends were used to self-fund the issue price for shares payable by scheme participants.

Removal of the inter company dividend exemption effectively introduced into such schemes a tax impost where there wasn't one previously. From that time, employee share schemes have by and large entailed a traditional employee share trust model by which a trust is established to hold shares for the benefit of the employees who qualify for the shares by completing a period of service with the company, often 3 to 5 years. These employee share trusts offered great attraction to employers and employees alike because they ensured that growth in value of the shares during the period of an employee's qualification was tax free, while the employee was sheltered from any downside in the event the shares were to fall in value.

In the eyes of Inland Revenue, the design of employee share schemes in such a way that they facilitated tax free gains in the value of shares while protecting participants from loss represented an unreal and unacceptable result. This concern prompted changes in the tax rules for employee share schemes (implemented in 2018) that deny this result.

An initial response to the 2018 tax changes was a shift in preference for employee share option plans. That initial preference appears not to have lasted and instead has been supplanted by a return to favour for employee share trusts.

The restored popularity for employee share trust arrangements is in part encouraged by their increased simplicity than was previously the case. They are simpler because they no longer contain complicated provisions designed to shelter employees from downside. The absence of such provisions also makes employee share schemes more commercial from the employer's perspective and consequently it is less of a challenge for directors to endorse them.

Offering shares to employees triggers disclosure requirements under securities laws (contained in the Financial Markets Conduct Act). Fortunately, these disclosure requirements are not cumbersome provided the number of employee shares issued or transferred in a 12 month period does not exceed 10% of the company's shares, the shares are issued as part of the participants" remuneration arrangements and capital raising is not the primary purpose of the offer. In these circumstances, all that is required is a warning statement and explanation of the offer, its risks and availability of further information.

Phantom schemes are sometimes preferred for their simplicity and flexibility. No shares or options are issued or transferred under a phantom scheme. Instead employees are paid a cash bonus that is calculated by reference to the uplift in value of a designated percentage of shares in the company. Because, no shares or options are in fact issued or transferred, there are no securities law issues, there is no dilution in actual shareholdings for existing shareholders (although profit participation is economically diluted) and there is no alteration of voting rights. Tax wise they are essentially neutral. If there is a disadvantage and/or complication it is that payment of the bonuses can strain cash resources and calculation of the bonuses can be complicated because it requires calculation of the value of the shares.

Trust Variations

How extensively can a trust be varied? For example, is it permissible to remove the majority of beneficiaries and appoint new ones or perhaps bring forward the distribution (vesting) date?

There are no easy answers here and care is needed to ensure that the scope of variations does not trigger a resettlement. If it does, then you have to be certain that the trust deed permits a resettlement. For example mirror trusts established by husband and wife, as a rule, cannot be resettled on a single joint trust in favour of the husband and wife. That would breach the trust deeds of each mirror trust which exclude the settlors' spouse as a beneficiary.

Tax consequences would also need to be addressed. Tax consequences on a resettlement arise because a resettlement is a taxable event, crystalising gains on trust held property which may or may not be taxable.

The starting point in varying a trust is to examine the trust deed to identify precisely what variations are permitted by the trust deed. Assuming the trustees have a broad power of variation, they may only exercise that power for a proper purpose. How might the trustees establish a proper purpose in removing one or more beneficiaries, and/or appointing other beneficiaries? Inevitably such action removes existing beneficiaries from any entitlement from the trust and/or dilutes their entitlement in favour of additional beneficiaries.

Reference is often made in answer to this to the substratum of the trust. It may be open to the trustees to establish a proper purpose by referring to the absence of any change in the trust's basic purpose. This assumes that the substratum or basic purpose of the trust can be identified.

It is often desirable to bring forward the vesting day or day of distribution. Conceptually, this is a variation to the trust. The power to achieve it, however, is a power of advancement, often hand in hand with the appointment of specified beneficiaries who are to receive a distribution. Again, it is critical to refer back to the trust deed to identify whether these powers are conferred on the trust. The key is then to ensure that trustees exercise the correct power and that they do so for a proper purpose. Provided, each of these boxes are properly ticked, a variation should be effective.

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