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Aren't political waverings fascinating. First, David Parker commissions the high net wealth information gathering request as a platform to support a capital gains tax. Then the Greens Party press for this to be extended to a wealth tax. Chris Hipkins evinces his concern at voter reaction by dismissing both a capital gains tax and a wealth tax. Grant Robertson and James Shaw are left fuming and David Parker asks to be removed as Minister of Revenue. Fascinating.

Meanwhile, the OCR remains unchanged for the first time in a while, but BNZ has raised its fixed mortgage rate anyway, attracting inevitable media response.... A 'pot pourri' of topical issues follows.

Distributions in Kind

Distributions of property in specie (or in kind) by a company to a shareholder on liquidation trigger a myriad of tax questions.

Invariably, no amount will have been paid for the property by the shareholder. Does this mean that the distribution attracts neither income tax nor GST because it has no value? The answer is ordinarily no. And is that also the case when a trust distributes a property in specie to a beneficiary?

I first address the income tax consequences before turning to the GST treatment.

For income tax purposes, the distribution of property to a shareholder in kind (where it is caused by the shareholding relationship in the company) is treated as a disposal by the company and an acquisition by the shareholder at market value. Inevitably, this brings the distribution within the dividend rules and that in turn leads to the question whether the property is a capital asset.

The distribution of capital property to a shareholder on liquidation is generally tax free. For revenue property on the other hand, the distribution will trigger a taxable dividend.

In the case of distributions of property by a trust, it is necessary to first establish the classification of the trust, namely whether it is a complying trust, non-complying trust or a foreign trust. It is then necessary to establish whether the property is on capital account or is revenue account property. For complying trusts that wish to distribute a capital asset to a beneficiary, it can be expected that the distribution will be tax exempt. If instead, the asset is held on revenue account, any gain element (determined by reference to the market value of the property at the time of distribution, less cost) will trigger a tax liability in the hands of the beneficiary.

Tax consequences for distributions from non-complying trusts and foreign trusts are more complicated and I can advise on them if you wish.

Turning to the GST consequences, the usual registration enquiries need to be made. If the transferor is GST registered, the distribution (be it by a company or a trust) will ordinarily attract GST on its market value unless the supply is zero rated or the recipient's GST registration causes the value of the supply for GST purposes to be nil. If the property being distributed is a share or a receivable, it will be an exempt supply and no GST will be applicable.

Bright-Line Test: Rollover Relief for Trust

Rollover relief, in the context of the bright-line test, negates taxation that would otherwise apply on the transfer of the land (i.e. residential land). An obvious example is transferring the matrimonial home into a family trust or transfer of the home out of the trust and back to the settlors.

When the bright-line test was first introduced there was no relief for transfers to or from a trust. This was subsequently rectified, but in a way that remained problematic. Further rectifications have now been made, and these are welcomed. Broadly, there is now relief for the transfer of residential land:

a) to a family trust;
b) from a family trust to the principal settlor where it is the same land that went into the trust (relief under this heading also applies where the land is transferred to a group of settlors, one being the principal settlor, where more than one person originally transferred the land to the trust);
c) from a family trust to the principal settlor of the trust, even where the land differs from that originally transferred to the trust, for example the matrimonial home has been sold and another bought in its place during the time of the trust's ownership; and
d) upon a resettlement of trusts, and the trust on which the land is resettled is closely related to the first trust.

As is often the case, the detail of these rules is complex. Nonetheless extensive rollover relief from the test for transfers to and from trusts is now available.

Trustee Tax Rate to Increase to 39%

The announcement in the Budget this year that the trustee tax rate is to increase to 39% from the 2024/25 tax year came as no surprise. The announced increase of course followed hot on the footsteps of the Government's high net wealth information project and the well publicised findings in that report. A key focus of that report was the widespread use of trusts in taking advantage of the 6% increment between the trust tax rate and the top personal rate.

The Budget announcement included an estimated additional $350m in tax per annum. Who will pay this? It will fall on the many trusts affected. It will be impactful.

Although the precise detail of the rules won't be known until the legislation is passed, three additional changes are noteworthy:

a) distributions made to company beneficiaries will not be taxed as beneficiary income in the hands of the company where the company is closely connected to the trust. This is an anti-avoidance rule;
b) in relation to deceased estates, the personal tax rate of the deceased will apply to estate income for the first 12 months; and
c) income derived by a trust that has been settled for the care of a disabled person will be taxed at the tax rate for the disabled beneficiary.

Limitations on Warranties

Warranties in a sale and purchase agreement are a key pressure point in negotiations between vendors and purchasers as they serve to allocate risk between them. Purchasers invariably commence negotiations with a 'your watch'/'our watch' sentiment, meaning that they expect the vendor to remain fully responsible for events under the vendor's period of ownership, whilst accepting responsibility for events occurring subsequent to the change of ownership.

In practice, few vendors accept that sentiment. Their starting point is often caveat emptor (buyer beware) and seek to place the onus on the purchaser to manage their risk by carrying out due diligence ('DD'). Whilst DD certainly reduces the risk for a purchaser, it does not remove it altogether and reliance on warranties remains. 'No warranty' deals are highly unusual.

The norm is for a vendor to provide reasonably fulsome warranties and to then seek to qualify their application by limitations inserted into the sale and purchase agreement. Usual limitations are:

a) A maximum threshold of liability for the vendor. Often this matches the purchase price, but equally it is not unusual for their liability to be capped at a proportion of the purchase price, say one half or two-thirds. It is unusual for the maximum liability to be less than one half of the purchase price.
b) A minimum threshold, excluding any claims for amounts that are immaterial and which, if made, would not warrant the administrative burden for the vendor;
c) Exclusion for items disclosed. These are commonly understood to include items comprised in the due diligence materials provided to the purchaser, subject to relevant information having been fully and fairly disclosed.
   Exclusion might also extend to items contained in a disclosure letter given by the vendor, often at the conclusion of DD. Delivery of a disclosure letter by a vendor needs to be carefully managed as it has capacity to catch the purchaser by surprise and, if not handled well, may give rise to some hostility. Most purchasers will not accept any

limitations against tax or environmental matters and disclosure letters seeking to do so are usually rejected.

d) Time periods. No vendor wants an unlimited period of exposure. To counter this, sale and purchase agreements contain provisions denying claims after a claim period has elapsed. A period of 24 months is common; longer than 36 months is highly unusual. Tax claims are again an exception for which the limitation period often matches the period within which Inland Revenue can ordinarily challenge an assessment, broadly 6 years.

e) Knowledge qualifications. Negotiation of warranties nearly always debates the scope of knowledge qualifiers. These are statements made against individual warranties that limit their operation to the vendor's knowledge and belief, usually after making appropriate enquiry. Often this leads to a carve-out for 'fundamental' warranties (such as good title) for which no qualification on account of the vendor's knowledge is permitted.

   Where warranties provide for a knowledge qualification, it then becomes necessary to establish whose knowledge is applicable. Is it only the knowledge of the seller, or should it be extended to include the knowledge of the senior management team. A solution may be to limit the qualification to the knowledge of the seller, subject to due enquiry having been made of the CEO CFO and COO.

Creditor Surprise Where Directors of a Failed Company Resurface under another name – Phoenix Companies

A recent article in the Sunday Star accompanied the collapse of Podular (a pre-fab company), entitled 'I'm deeply sorry, I take responsibility: Director of tiny home company gone bust is a former bankrupt'. The article discusses the fact that the director, Charles Innes, had been discharged from bankruptcy after the failure of several businesses but was nonetheless back at the helm of a new company, only for that company also to fail. As a consequence of that failure, more creditors suffered losses. How is this possible?

It is possible because company law treats the company as distinct from its directors and does not suppose that failure of the company is the fault of the directors. The starting point therefore is that directors of failed companies are not ordinarily banned from starting over. They will only be banned from doing so where the Registrar of Companies (usually upon application by a liquidator) issues an order banning a person from being a director, due to the person's actions having been the cause of a company's failure or because they have had two or more failed companies in the previous five years.

There are, however, provisions in the Companies Act that safeguard against a director of a struggling company simply starting up a new company, taking the assets and the name of the old company and leaving the creditors of the old company in the lurch. The safeguard here is certain provisions known as the 'phoenix company' provisions. Many commentators argue that the phoenix company provisions do not go far enough and their scope should be greatly extended. I agree.

Existing phoenix company provisions extend to and prohibit a new company, with the same or a similar name, taking on the old (failed) company's business, the same managers and directors and same assets. Often these transactions have aspects that are problematic:

- the phoenix company may have the same shareholders as the failed company. There is then a temptation for the directors to arrange for the phoenix company to pay no, or inadequate consideration for the business;

- the failed company, having received the sale proceeds may, pay some creditors, but not others. The creditors who are paid are usually suppliers with whom a continued relationship is necessary.

As may be evident, the phoenix company provisions can be avoided by the simple step of ensuring the new company does not take on the same name, or a similar name. In my view, this limitation should be removed.

A more comprehensive company law response to transactions that offend in this way lies in the directors duties. It will often be a breach of a director's duties to a company to permit a transfer of its operations to a new company. To avoid such a breach, the new company must pay fair value for the assets of the old (failed) company. It is not straight forward to apply directors duties in this context and a number of court cases illustrate that. A better, and in my view more prosperous, approach is to prevent a repeat of instances such as that with Podular and creditors by extending the scope of the phoenix company provisions.

Managing Trustee Conflicts

Trusts established in a private context, a family trust for example, invariably put the trustee in a position of conflict, in that he or she will inevitably be a beneficiary (excepting an independent trustee, such as your solicitor or accountant, of course). This will always be the case where the settlor is a beneficiary and follows the usual advice, that a settlor should be a trustee of his or her own trust.

How does this work in the context of trust law requiring that a trustee not place him or herself in a position of conflict?

A solution to this problem is possible, and it is to take advantage of an exception to the 'no conflict' rule by authorising it in the trust deed. The Trusts Act 2019 allows settlors to establish a trust with themselves and/or other family members as trustees on terms that specifically exclude the duties in sections 34 and 36, respectively to avoid a conflict between trustee and beneficiary and the duty not to profit from a trusteeship.

This is not a complete answer, however. It is common, and helpful, also to insert into the trust deed an express clause permitting the trustee to act as trustee notwithstanding the existence of a conflict of interest. Another solution is to permit conflicted transactions to be authorised by non-conflicted trustees. In all cases, whichever solution is adopted, it is subject to the qualification that a trustee must always remain answerable to the beneficiaries for any improper purpose in exercising his or her duty.

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