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The first quarter began and finished in a frenzy, largely driven by restructuring in advance of the trustee tax rate increase that took effect on 1 April. Shareholder rearrangements have also dominated, mainly attributable to the company requiring additional funds and one or more shareholders being unwilling or unable to contribute funds.

Other observations are that M & A activity is low, bank accommodation is tight (and expensive), alternative financing options are sparse and litigators are overwhelmed with company, trustee and family disputes.

Talk of a capital gains tax (CGT) continues to resurface. Commentary that the tax take is forecast to fall amidst record debt levels undoubtedly fuels argument in favour of a CGT. I don't discount introduction of a CGT in the near future. Perhaps at a lower (say 20%) rate and with carveouts for inheritance assets, notably generationally held farmland. Personally, I feel any CGT should be limited to gains on sale of a business, as economically, all other capital gains are truly an aggregation of wealth - and I don't favour a wealth tax as it is detrimental to savings.

Meanwhile, Speakman Law has moved into new premises in the General Building at 33 Shortland Street, the last 5 year lease at Kitchener Street having run out in a flash; very much enjoying being in such a stately building.

As usual, the topics below encapsulate recent activity here and I hope you find them of interest and helpful.

Increased 39% Trustee Tax Rate

The trustee tax rate now matches the top 39% personal tax rate. In some cases, this may prompt a decision to wind up the trust, perhaps because the advantage offered by the trust no longer outweighs the increased tax costs and pronounced reporting and compliance steps.

There are a number of tax considerations that may assist a decision whether or not to wind up a trust, detailed below:

a) **A company is owned by a trust and changes its dividend paying policy.**

The 11% margin between the respective company and trustee tax rates provides incentive to retain profits within the company and to pay them out only when funds are needed by the trust. Often this may reflect a change in the company's dividend paying policy with deferral of dividends and retention of company profits. Might these circumstances attract Inland Revenue concern that this represents tax avoidance? In most cases, no. Companies can legitimately make decisions about whether or not, or the extent to which, they retain or distribute profits. On its own, there is nothing artificial or contrived about this.

b) **A trustee distributes income to a beneficiary.**

This will result in the income being taxed to the beneficiary rather than at the trustee tax rate. Where the beneficiary is on a lower tax rate, or has tax losses, this will result in tax savings. Does this amount to tax avoidance? That is unlikely because trustees have a choice as to how to allocate income. Tax avoidance may however become a concern if a beneficiary (particularly one with tax losses) is appointed as beneficiary solely for the purpose of them receiving a distribution of trust income and a tax advantage is designed.

c) **A trustee adopts a company structure and transfers its income-earning assets to the company.**

Inland Revenue has publicly stated its view "that incorporating a company to hold income-earning assets while taking into account applicable tax rates is unlikely, without more (such as artificial or contrived features) to be tax avoidance".

Circumstances that may give rise to avoidance concerns are firstly where a holding company is interposed between an existing company and a trust and secondly, where personal services income is diverted by structuring revenue-earning activities through a company.

d) **Investment in a portfolio investment entity (PIE).**

A trustee may be attracted towards investing in a PIE in order to access the advantageous tax rate applicable to a PIE. Again, Inland Revenue has stated "that this would be unlikely, without more (such as artificial or contrived features), to be tax avoidance".

Exits Upon a Shareholder Dispute

Shareholder disputes relating to private companies often steer towards shareholder exit mechanisms. Usually it is the minority shareholder who is looking to exit.

The first port of call in these respects is the shareholders agreement, if there is one. Not all shareholder agreements contain exit mechanisms in the case of a dispute but some do. Usually, they will provide for some share valuation process and time frame for continuing shareholders to buy out an existing shareholder. Other possible scenarios are:

a) **Company Share Repurchases.**

Possibly the exiting shareholder is also an employee and is looking to terminate his or her employment with the company (and perhaps has obtained his or her shares pursuant to an employee share scheme). Where this is the case there is commonly a deed of repurchase in play. This will inevitably entitle the company to repurchase the departing employee's shares and correspondingly entitle the departing employee to compel the company to purchase his or her shares. Always consider tax consequences on a share repurchase as dividend substitution tests are applicable.

b) **Minority Buy Out Rights.**

In a limited set of circumstances, a minority shareholder may compel a company to repurchase his or her shares at fair value. These circumstances are alteration of the company's constitution, an amalgamation, entry into a major transaction and a proposed liquidation. Where one of these circumstances is the trigger for the dispute between the shareholders, the minority buy-out rights afford the minority shareholder a means of exiting the company at fair value.

c) **Drag and Tag Along Rights.**

These are commonly seen in a shareholders agreement (and are not otherwise available under the Companies Act). A drag along right entitles a majority shareholder to deliver 100% ownership of the shares in the company, by dragging minority holders. A tag along right allows a minority holder the right to require an exiting majority shareholder to include the minority holder in the sale.

In the absence of any of the forgoing being available, a shareholder's recourse is to negotiate an agreement or, as a last resort, to make an application to Court.

In striving towards a negotiated agreement there is invariably the obstacle that the shareholders each value their shareholding differently. In particular, a majority shareholder may argue in favour of a discount attaching to the minority holder's parcel. Possible solutions to this are:

Russian Roulette

This involves an initiating shareholder making an offer to the other shareholders to buy its shares at a stipulated price and at the same time entitling the recipient to require the initiating shareholder to sell its shares at the same price. The self-policing aspect to this mechanism ensures the initiating shareholder begins with a fair price.

Texas Shoot Out

Both (or all) shareholders submit sealed bids to an independent party with the highest price being operative. This acts as encouragement to approach a purchase on best price scenario.

In addition to the minority buy-out rights mentioned above, a minority shareholder is also protected by section 149 of the Companies Act. This section is an insider trading prohibition, denying a shareholder who is a director (invariably representing a majority or

significant interest) and who is privy to sensitive company information, from obtaining greater than fair value on sale of its shares or paying less than fair value on an acquisition of shares. There have been surprisingly few cases involving section 149, but a high profile case involving shares in Pushpay Holdings was determined late last year with heavy penalties awarded.

Transaction Steps Upon a Change of Shareholding

Shareholding rearrangements by which one shareholder exits and one or more other shareholders are substituted are currently commonplace. Below is a set of transaction steps required to implement a shareholding rearrangement.

a) Declare Fully Imputed Dividend

Where the exiting shareholder holds a significant interest, a first step will invariably be to declare a dividend and utilise existing imputation credits. That is necessary to ensure the benefit of imputation credits is not lost, which will otherwise result if the share transfer (together with any other share transfer in the period whilst a company has aggregated imputation credits) will trigger a change of shareholding of more than 33%. The dividend will trigger a resident withholding tax liability but that is a considerably lower price to pay than is losing the imputation credits.

Declaration of the dividend will require company and shareholder dividend statements, directors resolutions, a solvency certificate and an IRD RWT form. Directors who sign the directors certificate must ensure that the company has sufficient resources to enable it to pay its debts as they fall due and likewise be satisfied that the company's balance sheet will show a solvent position after payment of the dividend.

b) Share Transfer Documentation

In many instances, the transaction can be recorded in a simple share transfer, giving effect to the shareholder's exit and entry of the new shareholder(s). That transfer should then be registered at the Companies Office. In other cases, a sale and purchase agreement will be desired. That will be the case whenever the incoming shareholder requires warranties or specific terms apply. These may include vendor finance, an earn out arrangement, vendor continued assistance or a restraint of trade. If vendor finance is to be provided, it is preferable that this be recorded in a separate loan agreement and supported by security where available.

c) Share Subscription

A payment by an incoming shareholder to an outgoing shareholder will, on its own, provide no benefit to the company. The shareholding change may of course have been precipitated by the company's need for additional funds. A transaction step to reflect this is a share subscription agreement, by which the incoming shareholder agrees to subscribe for, and the company agrees to issue, new shares.

d) Balancing Share Issues

Potentially, balancing will be required to redress any unintended proportionate changes in shareholdings that the above steps produce. This re-balancing can be achieved by a fresh issue of shares to existing shareholders as necessary.

e) Consolidations and Amalgamations

Share rearrangements across a group of companies invariably invites review whether the need remains for all subsidiary (or sister) companies in the group. Where wholly owned group status exists, each member is able to form a consolidated tax group. That has the advantage of allowing intra group transactions to be ignored (for the most part) for tax purposes. Consolidation of group companies is, wherever available, strongly recommended.

Alternatively, there may be group companies that are no longer needed. One solution is to liquidate them. Another, and often more convenient, (and less expensive) route is to amalgamate them. Upon amalgamation, the amalgamating companies simply disappear and the assets and obligations become subsumed by the amalgamated company. In most cases, this step produces no tax consequences (though this should always be checked, as there are exceptions) and from a contractual point of view, nothing further is required. In summary, disposal of unwanted companies can often be readily achieved by amalgamation.

f) Shareholder Agreement

An incoming shareholder can be joined into an existing shareholder agreement by way of a deed of accession. This will bind the incoming shareholder to its terms as if it had been an original party. If no shareholders

agreement exists, we highly recommend that you take the opportunity to implement one.

Varying Trust Deeds Where No Power of Variation Exists

It is sometimes a surprise to review an 'older' form trust deed and find that it does not contain a power to vary the deed (in some cases the deed permits variations of administrative matters only). This can be a problem where there is a wish to update the trust deed, as has recently become a standard exercise in order to limit or modify default duties that will otherwise apply under the Trusts Act 2019.

If there is no power to vary the deed what can you do?

One option is to resettle the trust onto a new trust, written in modern format. The resettlement is, however, a taxable event, hence that alternative is only recommended where the tax consequences are palatable. That will not always be the case of course, particularly where the trust holds land on revenue account or depreciation recovery will be triggered.

The Trusts Act provides other possible avenues. The first is the unanimous consent procedure in section 122. Conditions to this pathway are:

- all beneficiaries must consent to the variation
- the variation must be requested by each beneficiary
- Court approval is required where any beneficiary lacks capacity (e.g. a minor) or a person may acquire a beneficial interest at a future date or on the happening of a future event
- the trustee must agree to the variation.

A second avenue provided by the Trusts Act is offered by section 125. That section recognises that there will be circumstances where a beneficiary's consent is not available, for example the beneficiary cannot be located. Section 125 empowers Court to waive the requirement for a beneficiary to consent to a variation. This ensures that people with 'interests of a remote or negligible nature' cannot stand in the way of variations which are desired by beneficiaries with far more significant interests.

When considering an application under section 125, the Court must consider

- the nature of the beneficiary's interest in the trust
- the benefit or detriment to that person if the Court makes or refuses to make the proposed order
- the intentions of the settlor.

Case law has established that the Court will grant consent on behalf of extended family members (who can be considered remote) where the settlor has an immediate family and they are primarily the parties intended to benefit. It is less likely that section 125 would assist in the case of immediate family members from whom consent is not available.

In my experience, where the trust deed does not contain a power of variation and resettlement is not an option, notwithstanding the leeway offered by section 122 and 125 of the Trusts Act it is rare to be able to vary the trust deed without an application to the Court. A strong discouragement of course is the size of costs of an application and proceeding of that sort. These will likely be around $20,000.

Brightline Test on Residential Property

A welcome tax reform is reversion to a two year bright-line test on residential property, from 1 July. Property sales after that date will be only be subject to the bright-line property rule (automatic taxation on gains unless an exemption applies, such as for the main home) if the property is sold within 2 years of purchasing it.

The main home exemption comes with some limitations. More than 50% of the property's area must be used as your main home (a problem for bed and breakfast, backpacker operations, for example). Also you must use the property as your main home for a period of at least 50% of the duration for which you owned it.

Rollover relief applicable to transfers to associated persons, notably family trusts is available. If relying on these, take care to review the classes of beneficiaries of the trust, as this may deny relief that would otherwise be available.

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