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It feels like the end of the year has been overtaken by two fabulous world cups and an election. Some lovely weather has been a Godsend too.

Nonetheless there continues to be plenty of activity, most of it positive – not so if you are exposed to prevailing high interest rates, or having to compete in the supermarket business! As usual, what follows is a snapshot of items that have crossed my desk in the last 2 or 3 months (hence topical). I hope you find them of interest.

When is a Loan to a Beneficiary in Truth a Distribution?

Trustees are often presented with the choice whether to apply funds to a beneficiary by way of a distribution or by way of loan. A distribution of income will be taxable in the beneficiary's hands and this has historically often favoured retaining the income in the trust for it to be taxed at the trustee tax rate. The funds might then be paid to the beneficiary as a loan.

From 1 April 2024, this will all change as a result of the increase in the trustee tax rate, to 39%, from that date.

This may in many cases remove motivation for trustees to categorise payments to beneficiaries as a loan but nonetheless not uncommonly, that motivation will remain. A loan will not reduce the trust fund (and thereby ensures amounts remain available to the other beneficiaries) whereas a distribution to a beneficiary will certainly reduce the trust fund available to other beneficiaries. Thus, where it is the trustees' intention to preserve the trust fund for all beneficiaries' benefit, it will be appropriate for the trustees to categorise payments as loans and not as distributions. But are such payments really loans?

If a loan is intended, it is critical that the trustees take appropriate protective steps to safeguard the interests of the other beneficiaries. Security and or the right to charge interest would be appropriate. It certainly would not be appropriate for the trustees to advance trust funds to a beneficiary on an unsecured basis and without regard to the beneficiary's ability to repay. That is what occurred in a recent English Court of Appeal case, Sofer v Swissindependent Trustees.

In that case, failures on the part of the trustees in relation to the particularly large loan to a beneficiary in the amount paid to the beneficiary being treated as distributions, and the trustees were answerable to the other beneficiaries for their consequent loss. This is not an uncommon scenario and I urge trustees to act carefully when intending to make a loan to a beneficiary.

Is there Still Cause to Use a Trust?

The forthcoming increase in the tax rate for trusts, to 39%, poses the question whether there remain valid reasons to retain your family trust. Many people have chosen to wind up their trust out of abhorrence, or at the very least concern, at the trust disclosure rules introduced by the Trusts Act 2019.

Others have chosen to wind up their trusts for fear of being sued, in light of the extended trustee duties and greater challenge rights available to beneficiaries under the Trusts Act.

These concerns beg the question whether or not to retain your trust.

A trust is certainly favourable to shelter pre-relationship assets where you enter into a new relationship. A trust is also a convenient vehicle to allocate trustee income among beneficiaries, whether they be on a low marginal tax rate, in a tax loss situation, or simply in need.

There are two other factors that may influence the decision to retain a trust:

a) Long term retention of an inter-generational asset (the family bach for example); and

b) Safeguarding assets against the introduction of a wealth based form of taxation, including possible death duties.

As to the first of these, the sentiment that often attaches to the family bach makes it wholly common for there to be a desire to retain it in the family for future generations. A trust neatly serves that purpose, though it is strongly recommended that a provision is inserted into the trust deed that records the settlor's intentions to this effect. This enables trustees to fall back on that to support, if needed, their decision to retain the bach notwithstanding market falls.

As to the second of these, the continued absence of a wealth based tax can't be guaranteed for our lifetimes. Safeguards against them is desirable. Likely, a trust will prove the best form of safeguard.

Deposit Takers Bill

Largely unnoticed it seems is the passage of the Deposit Takers Bill through Parliament, affording depositors considerable protection. It is a significant step particularly when you pause to consider the recent Silicon Valley Bank collapse and the exposure depositors would have faced absent a Govt bail out. So I see it as very opportune and welcome protection.

Briefly, banks and non-bank deposit takers in New Zealand will belong to a depositor compensation scheme that will provide for compensation of up to $100,000 per depositor in the event of a bank/deposit taker collapse. The scheme is to be self-funded by the participating banks and deposit takers. It is a very welcome step.

Companies (Directors Duties) Amendment Bill

This has now, somewhat controversially, passed into law. It requires directors to give more weight to environmental, social and governance factors in the exercise of their duties.

On its face, that may appear appropriate but the detail creates more uncertainty, in my view, than was previously the case and it presupposes that directors do not already have regard to these factors, and of course they do. National and Act both opposed the Bill, only to be out voted. It will be interesting to see, once present coalition talks are resolved, whether the new Government abolishes it. Nonetheless, for the moment, directors need to be aware of it and adhere to it.

Private Company Deadlocks

A deadlock between two shareholders, one a majority holder, and the other with a minority holding (say 20%) is common.

Minority shareholders are of course those who are most vulnerable and company law recognises that vulnerability. Consequently, the Companies Act affords a variety of protections, most notably minority buy out rights in response to a major transaction and unfair prejudice/oppressive conduct rules.

It is not just a minority shareholder however who stands to be prejudiced. One instance when this issue may surface is in the context of a share sale. Many cases establish that a shareholder can essentially sell his or her shares to suit. In other words a majority shareholder who wants to sell his or her shares cannot force the minority shareholder to do likewise. Thus a sale which is premised on the purchaser obtaining a 100% shareholding can be thwarted by a minority shareholder who is essentially empowered to hold the majority shareholder to ransom. Essentially this is what happened in a case two or three years ago named Dold v Murphy.

A solution to this problem is a shareholders agreement that contains suitable drag along rights. These will entitle a majority holder to force the minority to sell their shares on the same terms as those offered to the majority shareholder. Be careful in scripting these rights. Invariably, tight time constraints will be at play. This makes it unwise to build in provisions, such as valuation rights, which have potential to cause delay and imperil the sale transaction. In my view it is best to keep drag along rights simple, essentially having the minority holder ride on the coattails of the majority holder.

Gifts to Defeat Creditors and/or Spouses

A person exposed to creditor claims under a guarantee, or simply from trading, may be encouraged to gift assets to a trust or to his or her spouse in order to safeguard his or her assets. Will this protect the assets against challenge?

It will do unless the creditor can invoke a clawback provision. What are those provisions? In the case of an individual debtor, a creditor's primary recourse is the Insolvency Act. Under that Act, a gift made by a bankrupt to another person may be cancelled on the Official Assignee's initiative if the bankrupt made the gift within 2 years of being adjudicated bankrupt (the period extends to 5 years if the bankrupt was unable to pay his or her debt throughout that period). Where a person makes a gift to a spouse to shield assets from

that person's creditors, the creditor will have recourse to clawback provisions in the Property (Relationship) Act. Recourse will only be available where an intention to defraud creditors is established.

Where the debtor is a company, similar recourse is available to a creditor under the Property Law Act.

Where a gift is intended, a donor needs to take care to ensure that the elements needed for the gift are adhered to. For example, a gift of land will require the donor to have delivered to the donee a transfer instruction so that it falls under the control of the donee to effect the transfer. Similarly, in the case of shares, the donor will need to have delivered a signed share transfer to the donee.

Where a gift is only partially perfected, inevitably a resulting trust will arise in respect of the 'gifted property'. That trust will be in favour of the donor. This is often significant in a family setting where informality reigns. For example, it is not uncommon of course for a parent to financially assist an adult child into the purchase of a home. Is that assistance best to be by way of loan or by way of a gift? If it is the latter, then the amount gifted will inevitably be relationship property in which the adult child's spouse will have a 50% share (all other things being equal). Thus, if a relationship property claim is made, it will suit the parent (and the adult child) to assert that the gift was a loan. In some cases that may be hard to argue and it may be more apt to assert that the gift was incomplete. That would result in the 'gifted property' reverting back to the parent (under a resulting trust) just as if the parent had made a loan.

Limited Partnerships – Entry and Exit of Partners

The disposal of a partner's interest in a limited partnership ('LP') is treated as a disposal of the partner's share of the assets of the partnership. Where those assets are held by the partnership on revenue account, this is a taxable event i.e. there is potential for the outgoing partner to be taxed on any amount he or she receives. From my experience, many people do not know about this consequence, hence a little more detail follows.

There are two broad scenarios. The first is where safe harbour rules (explained below) apply. In that case, a partner who disposes of his or her interest in the LP is exempted from any tax liability that might otherwise arise for him or her on any disposal payment he or she receives. On the other hand, where the safe harbour rules do not apply, the outgoing partner is treated as having sold his or her proportionate share in the underlying assets of the LP. An outgoing partner will be taxed on any amount received on sale of his or her partnership interest where the underlying assets of the partnership are on revenue account (i.e. they are not capital assets).

The position for an incoming partner mirrors these results. Where the safe harbour rules apply, the incoming partner steps into the shoes of the outgoing partner and is treated as having acquired his or her proportionate share of the underlying assets at the same date and with the same cost base as the outgoing partner. Consequently, the amount actually paid by the incoming partner (or for an increased share in the LP in the case of an existing partner acquiring a greater interest) is irrelevant.

Where the safe harbour rules do not apply the incoming partner is treated as acquiring the underlying assets of the LP for the amount paid by the incoming partner. Where the value of the assets has fallen, it will be advantageous for the incoming partner to attain a cost base that mirrors the consideration paid by the incoming partner. In these circumstances it will generally advantage the incoming partner for the safe harbour rules not to operate.

It will be evident from the discussion above that operation or otherwise of the safe harbour rules is often crucial to the tax outcomes on entry and exit of a partner. What then are the safe harbour rules?

The first involves a threshold amount of $50,000. It applies when the disposal payment received by an outgoing partner is no greater than $50,000 above the net tax book value of the partner's interest. To put it another way, if a partner sells his interest in the LP for an amount more than the net tax assets of the LP, and the excess is greater than $50,000, then the first safe harbour rule will not apply.

There are additional safe harbour rules that apply to specific asset classes. These have the result that a disposal amount received by an outgoing partner is excluded income for him or her. These are:

a) trading stock (excluding livestock) where the total turnover of the LP for the income year of disposal is $3,000,000 or less;

b) depreciable property (not including intangible property) where its total cost to the LP is $200,000 or less;

c) financial arrangements and certain excepted financial arrangements, provided the LP does not derive income from a business of holding them (broadly loans and shares);

d) short-term agreements for the sale or purchase of property or services (short term broadly means settlement within 93 days);

e) certain livestock.

It is possible that the safe harbour rules may have unwanted tax consequences for an incoming partner. In that instance, the tax consequence will need to be priced into the consideration payable for the partnership shares.

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