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THE COMPANIES ACT 1993
IMPLICATIONS ON THE SALE AND PURCHASE OF SHARES IN
A SMALL COMPANY

LLM RESEARCH PAPER

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ABSTRACT

The object of this paper is to consider the Companies Act 1993 in the context of the sale and purchase of the shares in a small company and to compare the powers, management and procedures for companies which are re-registered or incorporated under the Companies Act 1993 of the Act with the powers, management and procedures for companies incorporated under the Companies Act 1955 .

To illustrate the changes and similarities between the two Companies Acts, the paper will consider an example of a company share sale and examine in the context of commercial and tax considerations matters arising from the passing of the Companies Act 1993.

This paper comprises approximately 15,900 words (excluding footnotes, annexures, schedules and bibliography).

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provides a set of facts and uses those facts to explore the issues and considerations which will arise as a consequence of the 1983 Act.

Notwithstanding that the primary focus of the paper is on the effects and consequences of the 1983 Act, the paper will touch on tax and commercial considerations which need to be addressed in negotiating the sale of a small company.

The Companies Bill 1980, as reported back to the House of Representatives from the Justice and Law Reform Committee (dated 15 December 1980), and as amended by a Supplementary Order Paper dated 14 September 1981, received its third reading and was passed by Parliament on 14 September 1981. At the date of this paper (that is 20 September 1981) the Bill awaits Royal assent. However, this paper will refer to clauses in the Bill as sections and refer to the Bill as passed by the third reading as "the 1983 Act".

The Financial Reporting Bill, the Takeovers Bill and the Companies (Auxiliary Provisions) Bill, as reported back were amended by Supplementary Order Papers and passed by Parliament on 14 September 1981. The Bill still awaits Royal assent. However, this paper shall refer to the Bills as Acts which together the reference will be to "the Auxiliary Acts".

TOPIC: The Companies Act 1993 - Implications on the sale and purchase of shares in a small company.

I INTRODUCTION

This paper will consider practical and legal effects and consequences the Companies Act 1993¹ and the Ancillary Acts² will have on the sale and purchase of the shares in a small company.

The paper provides a set of facts and uses those facts to illustrate and explore the issues and considerations which will arise as a consequence of the 1993 Act.

Notwithstanding that the primary focus of the paper is on the effects and consequences of the 1993 Act, the paper will touch on tax and commercial considerations which need to be addressed in negotiating the sale of a small company.

1 The Companies Bill 1990, as reported back to the House of Representatives from the Justice and Law Reform Committee (tabled 15 December 1992) and as amended by a Supplementary Order Paper dated 14 September 1993, received its third reading and was passed by Parliament on 14 September 1993. At the date of this paper (that is 30 September 1993) the Bill awaits Royal assent. However, this paper will refer to clauses in the Bill as sections and refer to the Bill as passed by the third reading as "the 1993 Act".

2 The Financial Reporting Bill, the Takeovers Bill and the Companies (Ancillary Provisions) Bill, as reported back were amended by Supplementary Order Papers and passed by Parliament on 14 September 1993. The Bill still awaits Royal consent. However, this Paper shall refer to the Bills as Acts whilst together the reference will be to "the Ancilliary Acts".

II THE EXAMPLE

A Fact Situation

- 1 The Company ("the Company") was incorporated on 1 January 1970 and has an issued and paid up capital of \$1.5 million being 1.5 million \$1.00 shares which were all issued at par.
- 2 The vendors ("the Vendors") of the shares are husband and wife, each owns 50%, each is employed by the Company and each is a director.
- 3 The Company has only carried on the business of printing and has 20 staff.
- 4 The Company has acquired a number of assets (including land and buildings) in addition to printing plant and equipment and stock.
- 5 The Company has a balance date of 30 June. The balance sheet of the Company at the commencement of negotiations between the Vendors and Purchaser is annexed.³
- 6 The Bank has a debenture ("the Bank's Debenture") over the Company assets and undertakings, a mortgage over the Company's land and buildings and a hire purchase agreement with Financier which relates to its principal printing press.
- 7 The Company is taxed as an ordinary company under the Income Tax legislation.

³ Annexure 1.

8 The Purchaser ("the Purchaser") has previously undertaken a number of businesses successfully but has no experience in the printing industry.

9 The Purchaser wishes to purchase a printing business.

B Purchaser's Strategy:

The Purchaser is an individual who wants to control the Company in all respects. The Purchaser acknowledged that he must retain the proprietors of the business so that he can learn the business.

The Purchaser wanted to purchase the business or the Company carrying on the business for as little as possible but has \$100,000 cash for the purpose.

C The Deal Negotiated

Purchaser or his nominee, Nominee Company Limited, will buy all of the shares in the Company then on issue from the Vendors for \$1 million. Settlement date for the purchase of shares is for 1 August 1994 ("settlement date").

The purchase price has been derived by reference to an adjusted balance sheet and to commercial negotiations.

The purchase price will be satisfied as follows:

- (a) The first \$100,000.00 will be satisfied by the Purchaser paying in cash; accepting liability.

- (b) The remaining \$900,000.00 shall be paid by 35 consecutive monthly instalments \$10,000.00 each and a final payment of \$570,000.00 on the third anniversary.

Prior to settlement date the Company will undertake the following transactions or actions:

- (a) the Company's land and buildings will be sold at market valuation to a company incorporated by the Vendors ("Newco").
- (b) The Company and the Newco will enter into a lease for 3 years at market rent.
- (c) The Company will declare a dividend which shall be payable to the Vendors as shareholders to use up all imputation credits available to the Company.
- (d) The Company shall repurchase from the Vendors the number of shares required to bring the net tangible asset backing of the shares to \$1 million.

The unpaid purchase moneys will be secured by:

- (a) a mortgage of the shares in the Company given by the Purchaser in favour of Vendors, and
- (b) a second ranking debenture to be given by the Company in favour of the Vendors ("the Vendors' Debenture").

The Bank's Debenture secures an overdraft facility of up to \$300,000.00 for the Company's trading operations and a term loan which relates to the land and

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III PRELIMINARY - REASONS FOR PARTIES OPTING FOR SHARE
SALE AND PURCHASE

The Purchaser decided for commercial reasons to buy the shares in the Company. The primary reasons for the Purchaser's decision were:

- 1 The Purchaser had little or no access to capital to invest and accordingly wished to take over the business in the most cash flow efficient manner.
- 2 The Purchaser could easily take over the Company's existing credit lines with trade creditors since the Company remained the customer.
- 3 The Purchaser had approached the Bank for consent.⁴ The Bank was satisfied that it was adequately secured and agreed to continue its support for the Company. Likewise, the Financier considered that as it was the owner of the press and held personal guarantees from the Vendors and that there were not defaults under the agreement, there was little risk for it consenting to the change in the control of the Company.⁵
- 4 The Purchaser had no experience in the industry and therefore wished to have all structures systems and personnel in place. The Company had operated

4 It is common for Bank and financiers to provide in their debentures that in the event of a change in shareholding the debenture holder's consent is required. Failure to obtain the debenture holder's approval is frequently an event of default causing moneys secured to be payable upon demand and the floating charge to crystalise.

5 Financier had in its form of hire purchase agreement a requirement for the Company to obtain consent from Financier when there was a change in shareholding.

successfully for a number of years and there appeared little necessity for changing existing systems.

5 Although the Purchaser recognised that buying shares in a company which had traded may have its risks in terms of liabilities arising from existing but undisclosed or unknown creditors and the historical tax treatment of assets, the Purchaser considered that provided there were adequate warranties in the Agreement for Sale and Purchase of shares, the risk was worth taking. If the Vendors were unable to meet warranty claims the amount of any warranty or misrepresentation claim could be set off against unpaid purchase moneys (upon the assumption that the Company could meet the liability if and when called upon to pay).

6 The existing premises of the Company were ideal for printing business.

The primary reasons for the Vendors agreeing to sell the shares in the Company were:

- (a) the Vendors wished to retire.
- (b) selling the Company was the easiest method of selling the business since all that had to be sold was the shares.
- (c) selling the Company avoided substantial redundancy and severance expenses⁶ which would arise if the Company closed down and/or simply sold its assets.

⁶ Under the collective employment contract operating for most employees of the Company there were generous redundancy and severance terms.

(d) selling the Company as a going concern meant more value would be obtained than closing down the Company and selling off its assets.

(e) the sale of the Company enabled the Vendors to reorganise their financial affairs.

In considering the Financial Statements of the Company, the Purchaser scrutinised each item in the balance sheet and the profit and loss statements to determine whether:

(a) the assets were actually assets of the Company - the Purchaser considered:

(i) the terms of all supply contracts to see whether there were retention of title or Romalpa clauses;² and

(ii) the terms of the Bank's Debenture and the Financier's hire purchase agreement.

(b) the value of assets was as stated. The Purchaser examined invoices for stock, performed a selective stocktake and completed an assessment of the Company's

² Being the Financial Statements within the meaning specified in s 2 of the Financial Reporting Act 1993.

³ Presently there is no provision for registration of agreements containing Romalpa clauses. The proposed Personal Property Securities Act ("PPSA") (see New Zealand Law Commission Report No. 3) will require a creditor who wishes to perfect or secure his security interest (which phrase includes a Romalpa clause) in personal property in priority to others to register a financing statement.

IV DUE DILIGENCE

In the course of negotiations the Purchaser insisted upon undertaking a due diligence process in respect of the Company. The Purchaser knew that due diligence would enable him to assess whether particular items on the Financial Statements⁷ were correct, how the Company's tax affairs had been operated and whether the business was as the Vendors said it was. However, the Purchaser knew that due diligence, being for a limited duration, could only be taken so far and that the true picture would only become apparent after settlement.

In considering the Financial Statements of the Company, the Purchaser scrutinised each item in the balance sheet and the profit and loss statements to determine whether:

- (a) the assets were actually assets of the Company - the Purchaser considered:
 - (i) the terms of all supply contracts to see whether there were retention of title or Romalpha clauses;⁸ and
 - (ii) the terms of the Bank's Debenture and the Financier's hire purchase agreement.
- (b) the value of assets was as stated. The Purchaser examined invoices for stock, performed a selective stocktake and completed an assessment of the Company's

⁷ Being the Financial Statements within the meaning specified in s 8 of the Financial Reporting Act 1993.

⁸ Presently there is no provision for registration of agreements containing Romalpha clauses. The proposed Personal Property Securities Act ("PPSA") (see New Zealand Law Commission Report No. 9) will require a creditor who wishes to perfect or secure his security interest (which phrase includes a romalpha clause) in personal property in priority to others to register a financing statement.

debtors and creditors ledgers to ascertain the age and amounts. As a consequence of the examination, an adjustment was made to the Accounts so that debtors more than 120 days overdue were written off.

- (c) The Purchaser checked whether the Company's creditors were correctly stated. A check on the accounting for the hire purchase agreement for the printing press confirmed that interest had not been correctly accounted for⁹ and as a consequence the value of the asset was overstated. An adjustment to the Accounts was made to take up the understated interest and overstated value of the printer.

Additionally, in the course of due diligence the Purchaser made some investigations of the Vendors' circumstances. Although the agreement for sale and purchase of shares provided a warranty by the Vendors that they were the sole and beneficial owners of the shares, the Purchaser wanted to see whether the Vendors owed any money to any creditors who might take a share mortgage. The Company's share register¹⁰ showed that the Vendors were registered as the shareholders but the Purchaser knew that this did not necessarily mean that the Vendors were the beneficial owners of the shares.¹¹

⁹ The accounting did not conform to Statement of Standard Accounting Practice ("SSAP") No. 18 issued by the New Zealand Society of Accountants which deals with accounting for leases and hire purchase contracts.

¹⁰ Definition in s 2 of the 1993 Act.

¹¹ Share registers do not disclose trusts and mortgages. There is under present legislation no registry for share mortgages. Consequently, it is difficult to confirm whether shares have been mortgaged. A lender may register a transfer of the shares with the company and the mortgagor shall be entitled to have the shares transferred back once the loan has been repaid. Mortgages of shares are not commonly over shares in an unlisted company because the security is difficult to realise.

- (e) The Purchaser knew that historically purchasers of shares in unlisted and/or private companies have difficulty protecting their interests as purchasers. Purchasers have had to rely on the contractual provisions in the agreements for sale and purchase for shares to protect their positions or interest. However, the problem with contractual provision is that the provisions only operate once a misrepresentation or breach of warranty has occurred and by that time it may be too late to recover the situation or money. For this reason, the Purchaser made enquiries of the Vendors' personal positions to determine whether the Vendors may have mortgaged their shares in the Company.

The Purchaser included in the agreement for sale and purchase a provision whereby the Vendors warranted that they had authority to enter into the agreement and that there were no adverse interests, liens or mortgages affecting the shares. The Purchaser considered his risk that the shares had been mortgaged low because the Company had a history of trading profitably.¹²

¹² The proposed Personal Properties Securities Act will enable purchasers to protect their interests under an agreement prior to settlement. Section 27 of the 1993 Act confirms that shares are personal property. A purchaser will be able to see whether there are any interests in priority to his by searching the Personal Property Securities Register. Additionally, the purchaser will be able to file a financing statement on the personal property security register before settlement of a transaction to protect the purchaser's interest.

V **TAX CONSIDERATIONS**

A *General*

With any business acquisition or sale the tax considerations will have a major bearing on the structure of the transaction. The Vendors and the Purchaser addressed many tax considerations in their negotiations because of the variety of assets that the Company owned, the fact that the Vendors were employees and directors, the proposal for the Company to sell land and buildings to Newco (an associated person), whether the shares in or the assets of the Company should be purchased and whether the Purchaser or a nominee company of the Purchaser should purchase the shares.

B *Shares Versus Assets:*

The traditional views are that it is preferable for a vendor to sell shares in the company operating the business and for the purchaser to purchase the assets of the company.

From a purchaser's point of view the acquisition of a company means that the purchaser will inherit the company's tax position, that is, the actual and potential liabilities as well as the historical cost basis for depreciation and cost basis. The acquisition of shares also means that assets which had been acquired by the Company remain in the books at the price they were acquired at and subject to the depreciation regimes or rates previously applied by the Company.¹³

¹³ Subject to any legislative or regulatory change.

From the Vendors' point of view the sale of the shares is an easy method to divest themselves of the Company without having to wind the Company up or sell the business off in a piecemeal fashion. The sale of shares has, on the face of it, no tax consequences for the Vendors.

C Goods and Services Tax ("GST")

1 The share sale

GST does not apply to the sale of shares since the sale is categorised as a financial service and is therefore an exempt supply.¹⁴

2 The sale of land and buildings

Whether GST applies to the transaction is subject to the final structure.

If GST is levied at 12.5% on the supply of the land and buildings, ordinarily there is no adverse effect for the parties other than one on cash flow for Newco since both companies would be registered persons¹⁵ and the transaction would be a taxable supply¹⁶ in the course of their taxable activity. Generally the purchaser would pay the GST on settlement whilst the vendor would include the GST received in its next GST return. The receipt of the GST would give rise to a short term cash flow advantage for the Company since it would not have to account for the GST until the end of the Company's return period, which is unlikely to

¹⁴ Section 14 Goods and Services Tax Act 1985 ("the GST Act").

¹⁵ Defined in s 2 of the GST Act.

¹⁶ Defined in s 2 of the GST Act.

coincide with settlement date of the land transaction. However, in the Example, the consideration payable by Newco is satisfied by debiting the Vendors' current accounts and no payment is actually made. In consequence, there may be an adverse cash flow effect for the Company when the Company has to file its GST return and pay the difference between output tax and input tax.

GST will be at 0% if the sale is between two registered persons and it relates to the sale of a going concern.¹⁷ For a commercial building to qualify as a going concern, the Inland Revenue Department's guidelines¹⁸ specify that the property should be leased to at least 50% of its area although the IRD retains a discretion to allow the zero rating of the transaction below the 50% level.

While the property may be 100% leased after settlement of the sale, it is unlikely the IRD would accept that the property is leased prior to settlement since the Company would be both lessor and lessee.

The parties considered whether the Company could treat the sale of land and buildings as being a transaction not within the course or furtherance of its taxable activity. If it was not then the sale by the Company would not be a taxable supply and hence no GST is required to be charged. Given that occupation of the premises was essential part of the Company's business, the length of the time that the Company has owned the building, the depreciation claimed by the Company in

¹⁷ Section 11(c) Goods and Services Tax Act 1985.

¹⁸ Tax Information Bulletin Vol. 3 No. 5.

respect of the building, the rental saved by the Company and interest deductions claimed on account of the loan for the building, the parties considered it would not be advisable for the transaction to be treated as not part of the Company's taxable activities especially since the Vendors are providing warranties.

However, if the Company and Newco are members of the same group of companies for GST purposes, transactions within the group are not subject to GST.¹⁹ The Company and Newco can be grouped if the transaction occurs prior to settlement date for the share purchase since the two companies will be controlled by the Vendors.²⁰ After the transaction has been completed the Group can then be terminated and the two companies operate independently of each other. Purchasing a group company can be a problem because of the liability of the company purchased for GST if the company nominated to return GST in the group of companies has failed to do so. The Purchaser considered that there was a low risk in the Example since Newco had only just been incorporated, Newco's sole business would be its rental property to the Company and the Company would be nominated as the representative member.²¹

The Vendors and Purchaser agreed that Newco and the Company should be grouped and the transaction completed with no GST charged.

19 Section 55(7) of the GST Act.

20 Section 55(1) of the GST Act.

21 Section 55(3) of the GST Act.

D Stamp Duty

1 Share sales

There is no stamp duty payable on share transfers.²²

2 Sale of land and buildings

The conveyance of the land and buildings by the Company to Newco is subject to a stamp duty liability.²³ Stamp duty is assessed on the instrument evidencing the sale rather than the property the subject of the sale. It is the GST inclusive amount of the consideration on which stamp duty is assessed. To reduce the liability for stamp duty in the Example, the land and buildings are sold subject to the Bank's mortgage which secures the \$500,000 loan.²⁴ As a consequence, the consideration specified in the Memorandum of Transfer for the land²⁵ is \$300,000.00, that is, the market value of \$800,000.00 less the \$500,000.00 mortgage. By reducing the consideration in the foregoing manner, the stamp duty cost to Newco is reduced by \$10,000.00 if GST is not applicable or at the zero rate.²⁶

22 Stamp and Cheque Duties Act 1971.

23 Stamp Duties Act.

24 If the Company and Newco are part of a consolidated group the obligation in respect of stamp duty is merely deferred.

25 Land, for the purposes of land law, includes buildings.

26 Stamp duty is assessed at 1% to \$50,000, 1.5% on the next \$50,000 and thereafter 2%.

E Capital Gain

The Vendors considered it unlikely any capital gain derived by them on the sale of shares in the Company would be likely to be subject to any income tax liability for the Vendors. The provision in the Income Tax Act 1976 ("the IT Act")²⁷ which could make profits on the sales of shares taxable, did not apply to the Vendors' circumstances given that the Vendors did not incorporate the Company with a view to trading in the shares (the Company was formed so as to conduct business with limited liability). Similarly the Purchaser considered his own circumstances and decided that since he was buying the shares with no intention to trade or sell, but merely for the purpose of acquiring the business, it was unlikely that any capital gain on the shares would be assessable income for him.

F Tax Losses and Imputation Credit Accounts

Losses and Credit balances in the Imputation Credit Account are valuable assets of the Company. Often transactions are usually structured to ensure the best use of the imputation credits and tax losses. The imputation regime was designed to stop double taxation of company earning. Imputation credits attached to dividends reduce the income tax liability of a shareholder in respect of dividends received from the Company.²⁸ Tax losses and Imputation credits cannot be carried forward if the shareholding continuity requirements are satisfied.

²⁷ Section 65(2)(e) of the Income Tax Act 1976.

²⁸ Section 394A - 394ZZX of the IT Act.

Tax losses, on the other hand, enable the Company to offset losses carried forward against assessable income.²⁹

The sale of all shares in a company will mean the loss of the imputation credits and the tax losses. However, in the Example, the Company had no losses to carry forward and the parties agreed that a dividend be declared by the Company to use up the available imputation credits.

G Land and Buildings

With the sale of land and buildings being a component of the entire deal, the Purchaser and the Vendors had to consider:

- (a) What effect would the sale have on depreciation claimed/claimable by the Company? and
- (b) Whether there were any consequences for the Company arising from the sale in the context of Section 67 of the IT Act.³⁰

The parties determined neither issue was relevant to the circumstances in the Example. The depreciation on the building had been claimed on the cost price. The sale price of the building does not affect the Company's tax position in relation to depreciation claimed.

The provisions of section 67 are not applicable to the Company in the Example given that the Company

²⁹ Section 188(1) and (14) of the IT Act.

³⁰ The provision which deals with the taxation on gains on property transactions.

never had an intention to deal or develop the property and the property had been sold for a price similar to its cost price. The revaluations in the Company's Balance Sheet are not relevant to section 67.

The Purchaser had considered whether it would be worthwhile for the Company to retain the land and buildings until after the settlement of the shares since the loss on the sale of the building (that is the difference between its value in the Balance Sheet and the sale price) might have been able to be treated as a revenue item by the Company.³¹ If the loss is able to be treated as a revenue item and it occurs after settlement date, this would benefit the Purchaser since the loss could then be carried forward by the Company.

However, it did not suit the Vendors for the transaction to be completed after sale of the shares because they felt that they might lose control of the property and the transaction might not be able to be completed because the Solvency Test might not be able to be satisfied or the Purchaser or Nominee Company may change their minds.³²

H Fringe Benefit Tax ("FBT") and Dividends

With any company which provides benefits to employees Fringe Benefit Tax³³ will be an issue. Generally, all non cash benefits provided to shareholder employees will be deemed to be subject to FBT.

31 If the asset is treated as a fixed asset then under the SSAP 28, the loss is accounted for initially in the Profit and Loss statement.

32 After settlement date and the issuing of the Vendors' debenture.

33 Fringe Benefit Tax is imposed on all employers under ss 336N - 336Y of the IT Act.

The Purchaser considered the overdrawn current accounts of the Vendors who were employees of the Company and whether any benefits were provided to other employees. Fringe Benefit Tax had not been paid in respect of the current account and accordingly an adjustment was made by debiting the current account with interest at a rate equal to the prescribed rate so there is no fringe benefit not previously charged.

The Vendors were careful to ensure that there was no dividend for tax purposes³⁴ or fringe benefit tax liability for the Company³⁵ arising from the sale of the land is to an "associated person".

To protect himself in the event of there being a fringe benefit tax liability for the Company, the Purchaser included in the agreement for sale and purchase a provision that the Purchaser or Nominee Company may, if the claim for FBT is valid, call upon the Vendors to reimburse and/or indemnify the Company for the amount of the fringe benefit tax paid.

However in the Example the Vendors obtained market valuations (2) to confirm the market value. The valuations provided were conducted on the basis of tenanted and untenanted premises. The valuations confirmed market values of \$780,000.00 and \$800,000.00. The Vendors chose the higher value so as to reduce any risk that the Inland Revenue Department would find there to be a cash benefit if there was decided to be a dividend under Section 4.1 of the IT Act.

³⁴ Section 4 of IT Act. Section 4(1)(c) specifically provides a formula for the calculation of the value of the non cash benefit.

³⁵ Under Section 4A of the IT Act.

I Depreciation

By acquiring the Company the Purchaser does not acquire a new cost base for assets owned by the Company notwithstanding the price paid for the shares. As a consequence the Purchaser of the Nominee Company will not obtain a tax deduction for that portion of the purchase price equivalent to the excess of the market value over tax book value of trading stock and depreciable assets. However the purchase price being paid by the Purchaser is his view of the net tangible asset backing of the shares (excluding the financial assistance for the unpaid purchase moneys) and in consequence the Purchaser considers that the value of plant and equipment does not need to be adjusted.

J Accruals Tax Regime

The Accruals Tax Regime³⁶ is intended to tax returns on financial arrangements on a progressive basis over the term of the transaction.

Where payment is made over a deferred period there is imputed to be an interest component in the amount paid unless the parties state that the amount to be paid does not include interest. The IT Act seeks to identify the "core acquisition price"³⁷ and any divergence from that price is taxable in the hands of either the Vendors or the Purchaser depending on whose benefit the gain is received.

The Vendors ensured that the agreement for sale and purchase for the shares provided that the price of

³⁶ Contained in ss 64B - 64M and 104A of the IT Act.

³⁷ Section 64B of the IT act.

\$1,000,000.00 was the lowest cash price³⁸ so that it was apparent that no interest was included in the price.

K The Qualifying Companies Regime

The Vendors had elected not to make the Company a qualifying company³⁹ for tax purposes. Whilst the Company had been eligible to become a qualifying company the Vendors had decided that the disadvantages outweighed the advantages.

The main disadvantage was the one-off qualifying company election tax ("QCET") payable on entry to the regime on the revenue reserves. The QCET is generally 33% of the revenue reserves but for companies such as the Company which was incorporated on or before 30 November 1991 which elected to become Qualifying Companies for the 1993 tax year a concessional rate of 7.5% is applied.

However, the Company had during the transitional year revenue reserves and with no apparent need for cash the Vendors did not consider the one off tax worth paying since the Company was in a position to pay imputed dividends.

The Vendors noted that one of the advantages with qualifying companies was that dividends paid to New

³⁸ Determination G17(b) is the relevant IRD determination for deferred property settlements and provides that a deferred property settlement is "an agreement for the sale and purchase of property for a specified option where payment in full is not made at the time at which the first right in the specified property is to be transferred".

³⁹ The qualifying regime is a tax regime only and has no effect on its corporate law status and is contained in Part XIIIAA of the IT Act. In general terms the regime treats the Company and its shareholders as one entity for income tax purposes.

Zealand residents are either imputed to the extent of available imputation credits or exempt tax and as a consequence. Thus capital profits could have been distributed to shareholders free of tax without having to wind up the Company.⁴⁰

The Purchaser considered that he could make use of the Qualifying Company regime once the acquisition of the shares was complete. The Purchaser's only source of funds to pay the purchase moneys to the Vendors was the Company by way of loans, dividends, director's fees or from salary. The Purchaser arranged that the Company may be in a loss-making (for tax purposes) position subsequent to settlement because of the payments requiring to be made. If the Company became a loss attributing Qualifying Company, then losses could be passed via the Nominee Company to the Purchaser as shareholder. However the Purchaser did note that with any company which may struggle in cash flow terms the assumption of the Company's tax liabilities of the Company may not be worth the risk for the Purchaser or Nominee Company.

However, if the Company's position changed so that it had limited reserves and was likely to make significant capital gains then to access those gains without winding up the Company the Purchaser can make an election to enter the regime.

L Dividend or Share Repurchase Moneys

In considering whether the Vendors should procure the Company to declare a dividend or either a share

40

The 66% continuity of ownership requirements for the carrying forward of imputation credits are irrelevant since the shareholders obtain a benefit of the imputation credits immediately and no carrying forward is required.

repurchase, the tax benefit available to the shareholders and/or the Company had to be determined.

At the date of this paper, the repurchase of shares by the Company would generally speaking give a tax free benefit to the Vendors with no tax effect on the Company as the payment is in reduction of capital. However, it is probable that the tax regime will be changed so that the amount received or payable on a share repurchase is subject to tax consequences or for the shareholder/former shareholder as income.⁴¹

A dividend payable to the Vendors is only "tax free" to the extent that the imputation credits are available for use by the Vendors. In the Example, the imputation credit account stands to the credit of \$60,000.00. Accordingly the Company can declare a fully imputed dividend of \$180,000.00⁴² which would enable the Imputation Credit Account balance to be nil at the date of settlement but actually only be required to pay or credit to the shareholder \$120,000.00.

41 In other jurisdictions (for example the United States), the proceeds of the repurchase of shares is taxable.

42 Assuming for the purposes of this paper a standard tax rate of 33.3%.

VI WHY THE REQUIREMENT TO RE-REGISTER?

Why did the deal negotiated between the Purchaser and the Vendors require, as a condition of settlement, the Company to be re-registered under the 1993 Act and the adoption of a Constitution by the Company when:

- (a) re-registration has no effect on the ability of the Company to complete the sale of the land and buildings to Newco.⁴³
- (b) the Vendors had managed the Company in an informal manner as authorised by the Articles of Association⁴⁴ and the Purchaser anticipated managing the Company in a similar fashion to the Vendors except that he would be the sole director,⁴⁵ and there would be only one shareholder, Nominee Company.⁴⁶
- (c) the Company has profits/retained earnings available to pay a dividend which would use up the available imputation credits in the Company's ICA.
- (d) the Company could provide financial assistance to the Purchaser without re-registration if the circumstances could be tailored to come within one of the provisos to Section 62 of the 1955 Act.

43 Directors' self interest provisions are common to both the 1955 and 1993 Acts.

44 The Articles of Association for a private company generally authorise a director to vote in transactions in which they have an interest provided disclosure of the interest is made.

45 Section 126 of the 1993 Act provides a company must have one director.

46 Section 6 of the 1993 Act provides a company need only have one shareholder.

- (e) Directors do not incur the liabilities that they do under the 1993 Act in respect of transactions or actions by the Company which require certificates from directors concerning whether the Solvency Test has been satisfied or whether a particular course of action is in the best interests of the Company.

However, without re-registration under the 1993 Act the Company:

- (a) Is unable to purchase its own shares.⁴⁷
- (b) Is unable to declare and pay a dividend from sources other than profits.⁴⁸
- (c) Is unable to provide financial assistance of the type negotiated in the deal.⁴⁹

Additionally the Purchaser and the Vendors acknowledged that:

- (a) The Company would have to be re-registered by 30 June 1997⁵⁰ otherwise the Company would simply be deemed to be re-registered at the end of the transitional period. In the event of the Company being deemed to be re-registered, it would not have a Constitution until such time as the shareholders adopted one. With

47 The 1993 Act authorises a company to purchase its own shares, if provided for in its constitution, the 1955 Act does not. The cancellation of the shares upon repurchase by the Company gives effect to a reduction of capital by the Company in an informal manner.

48 Historically, the law has required any dividend declared and paid by a company to be sourced only from profits.

49 Section 62 of the 1955 Act prohibited financial assistance for the purchase of shares except if the circumstances of the financial assistance were within one of the provisos.

50 Companies incorporated under the 1955 Act are required to re-register within 3 years of 1 July 1994.

the amendment of the 1955 Act to incorporate provisions equivalent to some of those in the 1993 Act, re-registration may as well be completed sooner than later.

- (b) The Company could issue new shares in return for past future services which would suit the Purchaser who intended making offers of shares in the Company to valued employees which could reduce the Company's wages bill.⁵¹
- (c) With only one shareholder required for a company and no need for a company secretary, the Company can be easily operated.

Adoption of Constitution

Following re-registration of the Company, the Company may adopt a Constitution.⁵² It is not mandatory for a company to have a Constitution but for the transactions contemplated by the Vendor and the

⁵¹ Section 23 of the Companies (Auxiliary Provisions) Act 1993 specifies that the application will include the following:
(i) the name of the Company;
(ii) full names and residential addresses of directors;
(iii) the number of shares of the existing company and the rights, privileges, limitations and conditions attaching to each of those shares;
(iv) registered office;
(v) the proposed address for service of the company.

⁵² Section 23 of the Companies (Auxiliary Provisions) Act 1993.

⁵¹ Sections 39 and 40 of the 1993 Act.

VII RE-REGISTRATION AND ADOPTION OF CONSTITUTION

A *Re-Registration*

As a condition in the agreement for sale and purchase of shares entered into between the Purchaser and the Vendors, the Company was to be re-registered under the Companies Re-Registration Act 1993.

The Company must apply to the Registrar of Companies requesting re-registration.⁵²

The procedure which the Vendors can adopt in relation to re-registration is that after obtaining the consent of shareholders to the application to re-register and providing shareholders with a copy of the notice in the prescribed form, the application with the notice annexed can be filed at any time after the date specified in the notice which cannot be earlier than twenty days after the date the shareholder is sent the form of application with notice attached.⁵³

B *Adoption of Constitution*

Following re-registration of the Company, the Company may adopt a Constitution.⁵⁴ It is not mandatory for a company to have a Constitution but for the transactions contemplated by the Vendors and the

⁵² Section 119 of the Companies (Ancillary Provisions) Act 1993 specifies that the application will include the following:
(i) the name of the Company;
(ii) full names and residential addresses of directors;
(iii) the number of shares of the existing company and the rights, privileges, limitations and conditions attaching to each of those shares;
(iv) registered office;
(v) the proposed address for service of the Company.

⁵³ Section 123 of the Companies (Ancillary Provisions) Act 1993.

⁵⁴ Section 23 of the 1993 Act.

Purchaser the Company must have a Constitution which authorises and/or contemplates the following:

- 1 The acquisition of shares by the Company.
- 2 A director who has an interest in a transaction voting and participating at the Board meeting which considers the transaction.
- 3 The Company obtaining insurance in respect of employees and directors to the extent specified in the 1993 Act.
- 4 Persons other than the directors having management powers.

The Vendors and the Purchaser had both been involved with companies registered under the 1955 Act which had had Articles of Association based on Table A.⁵⁹ On the basis of their experience they did not think that the decision making procedure for management of the Company would change upon re-registration of the

⁵⁹ The 1955 Act will be amended by the Companies (Auxiliary Provisions) Act 1978 to include sections which specifically deal with management of the Company and which mirror the 1993 Act provisions.

⁵⁶ Section 10(1) of the 1993 Act.

⁵⁷ Where there is one director then references to Board in the 1993 Act refer to that director.

⁵⁸ Section 107 of the 1993 Act provides that major transactions must be approved by a special resolution of shareholders.

⁵⁹ Section 10(2) of the 1993 Act.

⁶⁰ The 1993 Act includes a model form of Articles of Association for a limited liability company in the Third Schedule.

VIII

MANAGEMENT OF THE COMPANY

A *General*

Unlike the 1995 Act before the 1993 amendment⁵⁵, the 1993 Act expressly provides⁵⁶ that the business and affairs of a company must be managed by, or under the direction or supervision of, the Board⁵⁷ of the Company.

However the Board's management function is subject to specific provisions in the 1993 Act and the Company's Constitution. Shareholders do have specific management functions vested in them by the Act⁵⁸. In addition, if the Constitution specifies as such, the shareholders may have additional management functions.⁵⁹

The Vendors and the Purchaser had both been involved with companies registered under the 1955 Act which had had Articles of Association based on Table A.⁶⁰ On the basis of their experience they did not think that the decision making procedures for management of the Company would change upon re-registration of the

55 The 1955 Act will be amended by the Companies (Ancillary Provisions) Act 1993 to include sections which specifically deal with management of the Company and which mirror the 1993 Act provisions.

56 Section 106(1) of the 1993 Act.

57 Where there is one director then references to Board in the 1993 Act refer to that director.

58 Section 107 of the 1993 Act provides that major transactions must be approved by a special resolution of shareholders.

59 Section 106(3) of the 1993 Act.

60 The 1955 Act includes a model form of Articles of Association for a limited liability company in the Third Schedule.

Company unless changes were required so as to reduce or avoid liability for them in respect of duties and responsibilities now placed on directors.

The Vendors and the Purchaser considered that the management provisions of the 1993 Act were intended to give effect to the principles that:

- 1 The Company shall be managed by the directors unless the 1993 Act specifically requires shareholders to exercise a particular power or the shareholders have agreed, by the adoption of a Constitution with specific management powers vested in the shareholders, that the Company is to be managed otherwise than solely by the directors, and
- 2 In the event of a management power being exercised by someone other than a named director, then that person should be subject to the same duties and responsibilities as a named director since the decision that is being made will have the same consequences as if it were a decision of the directors.

The nature of a relationship between shareholders inter se and between the shareholders and the Company has historically been one of an associative contract.⁶¹ That has now changed since the 1993 Act attempts to set out the contractual rights by reference to the Act and Constitution if the Company has one.⁶²

61 That is, the parties are associated but not strictly speaking contractually bound.

62 Part IV of the 1993 Act.

The adoption of a Constitution does not necessarily mean the delegation or placement of management powers in someone other than the directors. In the Example the reasons why the Purchaser and the Vendors agreed the Company would adopt a Constitution were to enable the Company to purchase its own shares and for directors to participate in a vote on a transaction where they had an interest.

The Vendors and the Purchaser considered whether as a result of management decisions being made by shareholder resolution in lieu of the Board, this was a general way of avoiding possible liabilities for directors since historically shareholders had not been subject to the same duties and responsibilities as the directors when they exercised or made management decisions.

If the Constitution of the Company confers a power on shareholders which would otherwise be exercised by the Board, any shareholder who exercises that power or who takes part in deciding whether to exercise that power, is deemed in relation to the exercise of the power or any consideration concerning its exercise, to be a director and subject to the same duties⁶³ as a director⁶⁴. A careful reading of the provision confirms that the occasions when the provision operates may be limited. The key is whether the Constitution of the Company confers a power on shareholders which would ordinarily be the Boards. If there is no constitution the provision does not apply. If there is a Constitution which does confer a power on shareholders which would otherwise be exercised by the Board, the shareholders can simply avoid liability

⁶³ As specified in Sections 109 to 116 of the 1993 Act.

⁶⁴ Section 104 of the 1993 Act.2

by exercising the power pursuant to sections in the 1993 Act which expressly provide authority to shareholders. Additionally the wording of SS 2 and 3 of Section 104 of the 1993 Act is ambiguous since the provision refers to "any" shareholder who exercises that power yet if there is more than one shareholder then the provision may not apply because the words are quite specific, "any" (that is one) shareholder who actually exercises the power.

The Purchaser noted the definition of 'Director' does not differentiate between those voting for and those voting against a decision and accordingly felt that if he were a minority shareholder in a company he would, if he did not agree with the motion, abstain rather than vote against a decision.

Upon reflection the Vendor and the Purchaser agreed that it was appropriate that if a management decision which will have a major effect on the Company then the person exercising that power must be subject to duties and responsibilities to the Company and shareholders.

As a consequence of shareholders or persons exercising management powers being deemed to be directors under particular provisions and subject to the duties placed on directors, the Act confirms that a shareholder's liability in respect of a share is any amount unpaid on a share, any liability expressly provided for in the Company's Constitution, any liability that arises for the shareholder by virtue of the shareholder exercising a power in lieu of the Board, and any liability to repay a distribution to the extent that the distribution is able to be recovered under the Act.⁶⁵

⁶⁵ Section 80 of the 1993 Act.

In this context, the Purchaser and the Vendors have considered the provisions of Section 86 of the 1993 Act which provides that if all persons⁶⁶ who are entitled to vote agree and concur, then a Company may dispense with procedures specified in other Sections of the 1993 Act.⁶⁷

⁶⁶ As distinct from shareholders. Section 86 of 1993 Act.

⁶⁷ Section 86 - persons entitled to vote may authorise the Company to dispense with procedures specified in other sections and:

- (a) authorise a dividend
- (b) approve a discount scheme
- (c) acquire shares in the company
- (d) redeem shares in the company
- (e) provide financial assistance for the purpose, or in connection with, the purchase of shares in the company
- (f) approve payment of a director's remuneration
- (g) pay to a director or former director compensation for loss of office
- (h) make a loan to a director
- (i) give guarantees for debts incurred by the director
- (j) enter into of a contract to do any of the things referred to in paragraphs (f) to (i) inclusive
- (k) issue shares otherwise than on a pro rata basis
- (l) enter into a transactions in which a director is interested and nothing in sections 118 and 119 shall apply.

Accordingly, if the course of action is one which can be proceeded with under Section 86 of the 1993 Act, then the shareholders can avoid liability under Section 104 and possibly the directors can avoid liability in relation to the particular action sanctioned by the persons entitled to vote since the directors have not made the particular management decision.

However the provisions of Section 86A of the 1993 Act appear to confuse the issue. The effect of Section 86A is to require a director who voted in favour to certify as to Solvency. The inference is that the Board must also vote in favour of the matter rather than simply the persons entitled to vote. Additionally Section 86 further complicates procedures for the Company by confirming on the one hand that a person can agree to vote in a particular manner in future but on the other providing that that person can revoke the agreement. This can lead to a difficulty for the Company which may have entered into an arrangement on the basis that shareholders would agree to a particular course of action being taken by the Company. If the Company has agreed to repurchase shares from employees if those employees leave the employment of the Company then if the shareholder changes his mind when it is time to repurchase this will cause the Company to default in its obligations under the repurchase agreement.

B *The Vendors' View*

The Vendors had always been the shareholders and directors of the Company. Any decision they had made regarding management of the Company had always been implemented (money and the law permitting) either by

shareholders' or directors' resolutions or simply implementing the decision.

The Vendors had never had formal meetings of directors or shareholders. When directors' or shareholders' resolutions were required, forms of resolution were prepared and signed.⁶⁸

The Vendors would not, in practice, change the way the Company made management decisions. They will for their part ensure that the Constitution authorised the directors to participate in voting on transactions in which they had an interest. The Vendors were advised that there may be some adjustment to the forms of resolution and registers required to be kept by the Company, such as the interests register⁶⁹, but this did not concern them.

Whilst the Vendors were conscious of the duties and responsibilities placed on them as directors (and for this reason had insisted that the decision by the Company to provide assistance for the Purchaser be made after their resignations as directors) they did not intend taking steps to avoid or reduce the risk of liability as directors other than maintaining their approach whereby they always sought to conduct themselves in accordance with the duties and responsibilities placed on them and took care to take reasonable steps to protect the interest of the Company. The Vendors believed that the Company had satisfied the Solvency Test at the times when, as

⁶⁸ The Articles of Association for the Company authorised the passing of directors' resolutions by all directors signing and Section 362 of the 1955 Act authorised the passing of shareholders' resolutions other than at a meeting. Similar procedures for the passing of resolutions by shareholders and directors apply under the 1993 Act.

⁶⁹ Defined in Section 2 of the 1993 Companies Act, 1993.

directors, they were required to give certificates that the Company satisfied the Solvency Test.

C Purchaser's View

Whilst he acknowledged the validity of the Vendor's view, the Purchaser considered his duties and responsibilities as a director generally and considered it desirable to determine whether his liability could be reduced if particular persons other than the directors were entitled to exercise management powers.

The Purchaser had experience with companies that had in their Articles of Association limitations on the directors' management powers.⁷⁰ Consequently, the Purchaser was not concerned if shareholders were to make management decisions since he would control the shareholder.

In this context the Purchaser contemplated who should be the purchaser or transferee of the shares in the Company, that is himself, a nominee company or a family trust, since:

- 1 if he could avoid liability arising from actions as a director for himself he wished to do so; and
- 2 if he was to incur a liability as a result of being a director he wished to ensure that as part of an asset protection plan assets under his control were not necessarily in his name.

⁷⁰ For example the Company could not purchase plant and equipment in excess of \$50,000.00 without a resolution of shareholders.

What had to be taken into account by the Purchaser was that, even if management functions are vested in and exercised by shareholders he, the Purchaser, would still be liable as a director as a consequence of

- 1 controlling the shares,⁷¹ or
- 2 the Purchaser being a director, that is he still has duties notwithstanding that the decision may have been made by shareholders

In relation to the transactions contemplated, the Purchaser decided that:

- 1 he will be the director of the Company.
- 2 Nominee Company would be nominated to purchase the shares in the Company and
- 3 the Nominee Company in turn would be owned beneficially by a family trust created by the Purchaser as settlor and the Purchaser would be a discretionary beneficiary of the trust.
- 4 Management decisions would be exercised by himself as director.

⁷¹ Nominee Co. is controlled by the Purchaser.

IX DIRECTORS' DUTIES AND RESPONSIBILITIES

A *Director Duties and Responsibilities*

The 1993 Act sets out the principal duties of a director.⁷² The 1955 Act did not until its amendment. The Purchaser considered the express duties. Relating those duties to the Example, and in particular to the Purchaser:

- 1 The director must act in good faith and in the best interests of the Company.⁷³ The Purchaser may, but not always, often have a conflict of interest with the Company. Although the Company and the Purchaser may have similar goals of seeking to make the Company a profitable venture, the cash flow required for the Purchaser's obligations will mean that he will always be anxious to draw his salary/drawings from the Company in order to honour his obligation to the Vendors yet such an action will reduce the Company's working capital.

- 2 The director must exercise the power for a proper purpose and must act in a manner which does not contravene the Constitution or the 1993 Act;⁷⁴ The Purchaser assumed that if a power is to be exercised for a proper purpose it must be a purpose within the law and the Constitution of the Company.

⁷² Sections 109 to 116 of the 1993 Act.

⁷³ Section 109 of the 1993 Act.

⁷⁴ Sections 111 and 112 of the 1993 Act.

3 A director must not agree or allow the business of the Company to be carried on in a manner likely to create a substantial risk of serious loss to the Company's creditors;⁷⁵ The proposal for the Company to provide security for the unpaid purchase moneys may arguably not be within the ambit of the duty since the issue of the debenture will mean that the priority of unsecured creditors is postponed behind those of a party who is not a true creditor of the Company (that is in the sense of having provided moneys to the Company or provided stock or materials) and the size of the financial assistance is such that if the debenture was called up, the unsecured creditors may be at risk of losing their money.

4 A director must not agree to the Company incurring an obligation unless the director believes at the time, on reasonable grounds that the company will be able to perform the obligation.⁷⁶ The Purchase had considered the Financial Statements prepared by the Vendors and the Company and in particular the forecast budgets which supported the financial obligations that the Purchaser and the Company were undertaking as a result of the Purchaser entering into the agreement for purchase and sale of shares and the Company deciding to provide financial assistance.

5 A director of a company, when exercising powers or performing duties as a director must exercise the case, diligence and skill that a reasonable

⁷⁵ Section 113 of the 1993 Act.

⁷⁶ Section 114 of the 1993 Act.

- 7 Agreement of persons entitled to vote (that is the Vendors) pertaining to the declaration of the dividend including a certificate given by the Directors (who will be the Vendors) in respect of the Solvency Test.
- 8 Agreement of persons entitled to vote (that is the Vendors) pertaining to the re-purchase of shares by the Company including a certificate given by the Directors (who will be the Vendors) in respect of the Solvency Test.

Settlement Date

- 9 Resignation of Vendors as Directors and appointment of the Purchaser as a Director.
- 10 Agreement of persons entitled to vote (that is the Vendors as shareholders) pertaining to the giving of financial assistance to the Purchaser by the giving of security including a certificate given by the Directors (who will be the purchaser) in respect of the Solvency Test.
- 11 Debenture by the Company in favour of the Vendors securing unpaid purchase moneys in respect of the shares.
- 12 Mortgage of Shares made between the Purchaser as grantor and the Vendors as grantee.
- 13 Registration of Share Transfers between the Vendors and Nominee Company

director would exercise in the same circumstances taking into account, inter alia:

- (a) the nature of the Company,
- (b) the nature of the decision; and
- (c) the position of the director and the nature of the responsibilities undertaken by him or her.⁷⁷

The problem for the Purchaser is that although he may be a novice in the printing industry, the director's duty of care is that of a reasonable director. To this end, the Purchaser considered that he would operate the Company in a profitable fashion provided the existing systems and personnel continue. The Purchaser's skills are directed at financial and organisational matters but he expects to learn about the printing industry from the Vendors during the period of their employment. To this end, the Purchaser considers he satisfies the duty.

- 6 If the director acts in good faith, and makes proper enquiry where the need for inquiry is indicated by the circumstances and has no knowledge that such reliance is unwarranted then a director may generally rely on reports, statements and financial data and other information prepared or supplied and on professional or expert advice given or taken.⁷⁸ The Purchaser relies on information compiled by the Vendors when acting as a director he gives

⁷⁷ Section 115.

⁷⁸ Section 116.

the Solvency Certificate at the time of the financial assistance to Nominee Company. The Purchaser relied on the material provided by the Vendors in his decision to proceed with the purchase. The Vendors' experience is vast and the Purchaser sees no reason to question the accounts and projected cash flows given the profitable trading history of the Company. The Purchaser, in any event, will act in good faith as is shown from the fact that he relied upon the information given by the Vendors when determining that he should proceed with the purchase of shares by his nominee.

The disclosure provision had always amused the Vendors because if the Company entered into a transaction with themselves they knew what was involved in the transaction and therefore saw little point in the practice of disclosing an interest in the context of their Company.

However, the Vendors had accepted that the reason for disclosure requirement was that directors were fiduciaries and as a consequence must disclose any interest so that the Company is aware of all circumstances before the Company enters into the transaction in which the Director has an interest.

The 1935 Act has been amended so that the provisions of that Act in relation to self interest transactions are similar to those in the 1993 Act. The sale of the

²⁰ "The Directors disclose that they are personally interested in the transaction the subject of the following resolutions in that they will derive a personal benefit".

B Self Interest Transactions

It had been the practice of the Vendors to include in Directors resolutions which related to transactions in which they had a benefit, a disclosure of interest clause⁷⁹ in the preamble to the resolutions.

The 1955 Act had historically provided that directors must disclose interests in a contract or proposed contract with a company and that such disclosure must be before or at the time the company is entering into the contract. The Articles of Association made provision for the Directors voting on resolutions in which they had an interest provided the interest was disclosed.

The disclosure provision had always amused the Vendors because if the Company entered into a transaction with themselves they knew what was involved in the transaction and therefore saw little point in the practice of disclosing an interest in the context of their Company.

However, the Vendors had accepted that the reason for disclosure requirement was that directors were fiduciaries and as a consequence must disclose any interest so that the Company is aware of all circumstances before the Company enters into the transaction in which the director has an interest.

The 1955 Act has been amended so that the provisions of that Act in relation to self interest transactions are similar to those in the 1993 Act. The sale of the

⁷⁹ "The Directors disclose that they are personally interested in the transaction the subject of the following resolutions in that they will derive a personal benefit".

land and buildings by the Company to Newco raised the issue of disclosure of interest by the directors.

Directors who are interested in a transaction may, if expressly authorised by the Constitution, vote on any matter relating to the transaction.⁸⁰ Likewise, subject to the Constitution of the Company, a director who is interested in a transaction entered into or to be entered into may attend a directors' meeting at which the transaction is to be discussed, sign a document relating to the transaction on behalf of the company and do any other thing in his or her capacity as if the director was not interested in the transaction.

Accordingly, the Vendors and Purchaser ensured that the Constitution included provisions for the Directors to vote and sign documents relating to the transactions. If there are no such provisions the Board of the Company can not act in relation to the proposal other than being required to provide the certificates for the solvency test⁸¹, although the giving of a certificate may not be authorised if the Directors have an interest.

The interests which would have to be disclosed in the context of the Example would include:

- 1 In respect of the sale of land and buildings and the lease of the premises - the Vendors' interest as owner of the shares in Newco.

80 Sections 122 and 122A of the 1993 Act.

81 Although the giving of a certificate may not be authorised if the Directors have an interest.

2 In respect of the provision of financial assistance, if the Vendors are directors at the time of the resolution the Vendors' interest as a consequence of obtaining additional security for the payment by the Purchaser of the purchase moneys for shares owned by the Vendors.

3 In respect of the financial assistance, the Purchaser's interest insofar as he or Nominee company is able to purchase the shares in the Company as a result of the Company providing the security for the unpaid purchase moneys.

The Purchaser noted however that he is not required to disclose his interest in respect of the guarantee given to the Bank in support of the Company's overdraft facility which represents a change from the previous practice.⁸²

The Vendors and the Purchase noted that they are required to provide⁸³, if possible, the monetary value of the director's interest which represents a change. Prior to its amendment the 1955 Act provided that a glib statement of interest or conflict was sufficient and no attempt was made to have the director disclose the monetary value. A general notice entered in the interests register in respect of a future transaction is deemed to be acceptable disclosure.⁸⁴

However what really concerned the Vendors was the provision in the 1993 Act (and now also the 1955 Act) which provides a specific restriction on the ability

82 Section 117(2) of the 1993 Act.

83 Section 118(1) of the 1993 Act.

84 Section 118(2) of the 1993 Act.

of a director of a company, who has received information as a consequence of being an employee or director material to the assessment of the value of the shares, disposing of or purchasing shares, as the case may be.⁸⁵

Under the provision the director may dispose of his shares without fear of sanction only if the consideration received for the disposition is not more than the fair value of the shares or securities. The fair value of shares or securities is to be determined on the basis of all information known to the director or publicly available at the time from presumably the financial statements.

As a consequence if the Vendors were to sell the shares for a price more than net asset backing (assuming that the financial accounts are publicly available and that net asset backing reflects the fair value), then the Vendors would be liable to repay to the Purchaser the amount over and above the fair value of the shares⁸⁶ thus depriving the Vendors of an opportunity to negotiate a "good deal" for himself. The difficulty with assessing the value of a small company is that intangible assets are often omitted from the Company's accounts and the Director may determine a value for intangible assets with which the Purchaser might not agree. The provision may for practical reasons require the Vendors to omit the intangible assets from his calculation of the sale price because of the risk to him.

The Vendors' did not think that they should be required to account for any amount over the fair value

85 Section 125 of the 1993 Act.

86 Section 125(4).

of the shares since it seems inappropriate that they, as the owners of the shares, should be penalised when the Purchaser is free to negotiate on his own behalf. In the Example the agreement for sale and purchase of the shares made between the Vendors and the Purchaser contains exhaustive representations and warranties and indemnities relating to the quality of the Company yet the Purchaser also has the backstop remedy under the Act to require repayment of monies if the Company's business is not what the Purchaser thought through no fault of the Vendor. The Vendors' view was that if such a provision is to apply then it should apply only to the large companies where inside information will provide a distinct advantage, but for the vendor of a small unlisted company⁸⁷ there is no such avenue for profit taking.

Consequently the Vendors considered that vendors generally would have to consider procuring the sale of assets by companies as opposed to the shares in companies since there is no equivalent provision for the accounting of variances from fair value.

The Vendors and Purchaser each had interests in the various transactions comprised in the Deal. However, both realised that the interests had to be disclosed.

The 1993 Act provides⁸⁸ that failure by a director to disclose an interest does not affect the validity of the transaction entered into by the Company or the Director - the Director however will be subject to the penal provisions. However it is also provided⁸⁹

87 There no longer being a distinction between private and public companies.

88 Section 118.

89 Section 119 of the 1993 Act.

that a transaction entered into by the Company is able to be avoided by the Company within three months of the transaction being disclosed to all the shareholders.

The two provisions can be reconciled on the basis that the transaction is fully effective unless avoided by the company.

A difficulty for shareholders in seeking to have the company avoid the transaction is that as a minority shareholder may have difficulty in having the Company act if the interested director is the majority shareholder.

In the context of the Example, there is probably no particular concern for the Vendors in relation to the transaction since disclosure is made. However, it may be a different scenario if the land and buildings had been sold at undervalue to Newco - the provisions of Section 119 enable any shareholder to seek to have the Company avoid the transaction without stating that the shareholder must have been a shareholder at the time the transaction occurred. On the face of it, the Purchaser, or at least Nominee Company would be entitled to use the provisions of Section 119 within the three months of settlement date to procure the Company to avoid the transaction.

The value of the land and buildings in the financial statements of the Company had been based on several revaluations conducted in previous years. However as a result of a reduction in the values of Commercial property the value of the land and buildings included in the balance sheet was significantly higher than the current market value but not dissimilar to the cost price.

²⁰ As defined in Section 119(1) of the 1985 Act.

X SALE OF LAND AND BUILDINGS

Newco acquired the land and buildings at current market value and Newco and the Company entered into a lease of the premises.

The effect of the transaction was to reduce the total assets and the total liabilities of the Company and to crystallise and account for the loss on the property, (which had the effect of reducing the net assets of the Company).

From a practical point of view the transaction involving the sale of the land and buildings is unaffected by the 1993 Act. The transaction would not be a substantial transaction⁹⁰ and as a consequence there are no special formalities pertaining to the transaction other than those which relate to the self interest disclosure provisions arising from the sale being to Newco, a company owned by the directors and shareholders of the company.

Given that the Vendors own all of the shares in the Company the sale can be effected under either the 1993 Act or the 1955 Act without difficulty by either directors' or shareholders' resolutions.

The value of the land and buildings in the financial statements of the Company had been based on upward revaluations conducted in previous years. However as a result of a reduction in the values of Commercial property the value of the land and buildings included in the Balance Sheet was significantly higher than the current market value but not dissimilar to the cost price.

⁹⁰ As defined in Section 107(2) of the 1993 Act.

As a result of the sale of the land and buildings the net assets of the Company were reduced by \$800,000.00. Attached as Annexure B is the Post Sale Balance Sheet of the Company.

One consideration for the Vendors was the provision in the 1993 Act which provides for the recovery of the amount of any undervalue from the other party to the transaction if property has been sold at under value within one year of the commencement of the liquidation.⁹¹ In the Example, the Vendors and the Company procured valuations of the land and buildings and as a consequence the property was transferred at the market price. Thus the undervalue recovery provisions can be discounted for the purposes of the Example.

⁹¹ Sections 260A of the 1993 Act.

XI CAPITAL MAINTENANCE AND STRUCTURING

A *Solvency Test*

The 1993 Act will provide a degree of expediency to procedures for capital restructuring, the making of distributions⁹² and the provision of financial assistance by companies. Whilst the procedure may be more expedient the standard by which such actions can be taken is no less stringent than under the regime which is being replaced by the 1993 Act. The new standard against which the Company will be judged is the Solvency Test.⁹³

There are two aspects of the Solvency Test, the first relates to cash flow, that is, does the Company pay its debts as and when they fall due, the second relates to its asset position, that is, is the value of its assets greater than the value of its liabilities.

Corporate solvency is the theme throughout the 1993 Act. The onus is on the directors to certify that the solvency test is satisfied even where the 1993 Act attempts to provide authority for the shareholders to determine matters pertaining to the structure of the Company.⁹⁴

The directors must assess whether the Company will satisfy the Solvency Test at any time when the Company will voluntarily reduce the amount of the Company's capital.

92 Defined in section 2 of the 1993 Act.

93 Defined in Section 4 of the 1993 Act.

94 Sections 86 and 86A of the 1993 Act.

B Times at which the test applies:

The Board of a Company must be satisfied that after the particular distribution,⁹⁵ acquisition of shares or instance of financial assistance by the Company and the directors who have voted in favour of it must sign a certificate stating that after the particular distribution, acquisition of financial assistance the Company will satisfy the Solvency Test. Every director who fails to comply commits an offence under the 1993 Act which can mean a fine of \$5,000 for the Director. Additionally, if circumstances change between the date the decision is made and the date the decision is to be implemented so that the Company will not satisfy the test, the particular action must be aborted otherwise the distribution, acquisition or financial assistance will be deemed not to have been authorised.

Where a distribution is made by a company and it transpires that the certificate given by the directors was incorrect, then the distribution will be recoverable from shareholders except in certain circumstances.⁹⁶ Directors are liable for the amount of the distribution in the event of the company being unable to recover the distribution from shareholders.⁹⁷ In the event of only part of a distribution causing the Solvency Test not to be satisfied, then only the amount by which the liabilities exceeded the assets will be recovered.

95 As defined in Section 2.

96 Section 48(1) of the 1993 Act.

97 Section 48(2) of the 1993 Act.

Given the liability of directors arising from an incorrect certificate, the directors must be careful to ensure that they are satisfied on reasonable grounds that the Solvency Test is actually satisfied in every respect before and after the distribution.

If the Company in the Example does not pay its creditors within the accepted terms of trade, the Solvency Test is not satisfied as it is not meeting its creditors or paying its debts as and when they become due.

The definition of Solvency Test gives rise to some issues for directors:

1. Liabilities include contingent liabilities. Contingent liabilities will include not only any guarantee given by the company must be taken into account but also any other claims made or pending against the Company. The difficulty which arises is what value is to be given to a contingent liability? Assessing a liability which has not crystallised can be extremely difficult.⁹⁸
2. Assets do not include contingent assets which may distort the assessment of solvency if a contingent liability is matched by the contingent asset.
3. If a company is a group member and is a party to a group charging deed, the Solvency Test for the

⁹⁸ For example, if the Company had received a threat to sue for losses arising from the faulty printing of a prospectus and the company in question was considering actions against the Company for consequential losses as the flotation had been delayed, what would be the assessment of the contingent liability?

company may never be satisfied since the amount of the group debt could alone be more than the value of the assets.

4. The definition of "Solvency Test" does not differentiate between current and term liabilities, nor does it distinguish between tangible and intangible assets.

The elements of sound financial structure for a company are considered to be as follows:

- (a) Current assets exceed current liabilities.
- (b) The sources of long term finance (ie long term liabilities plus owners equity) exceed the investment in long term assets.
- (c) The investment of the owners (shareholders equity) is at least one half of the total assets.

Thus one of the criteria of the solvency test may not be satisfied yet the Company can have a sound financial footing and have a surplus of assets over liabilities. Conversely the fact of no differentiation between term and current liabilities may mean that the Company might be considered not to have a sound financial structure yet the Company may satisfy the Solvency Test.

C Assessment of the Solvency Test

The Solvency Test requires the directors to have regard to the most recent financial statements of the company and all other circumstances which the directors know or ought to know affect or may affect the value of the company's assets and the value of its liabilities including contingent liabilities.

The definition of solvency test makes no allowance for the directors knowledge or skills and imposes liability where directors know or ought to know of circumstances which would affect the value of the Company's assets and liabilities.

In the Example, the Vendors are probably unaware of the purchasers' historical circumstances without investigation. Accordingly, the Vendors must, if they are directors at the time the financial assistance is given, investigate fully the circumstances regarding the Purchaser since if they do not, they will not be exercising sufficient due care to discharge the onus on them. However, the Vendors acknowledged this risk and for this reason will not be directors when the financial assistance is given.

The directors may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.⁹⁹ In the Example, the Vendors only obtained a valuation of the land and buildings, a transaction not relevant to subsequent transactions. No valuation was obtained by the Vendors of assets other than by reference to the book value of plant and equipment. The Purchaser merely enquired of the

⁹⁹ Subsection 4(2)(b) of the 1993 Act.

suppliers of plant and equipment what the market value would be. As a consequence the directors of the Company may be taking a risk if they do not seek to have the plant and equipment valued before a distribution. Arguably the Directors may not be taking reasonable care in assessing whether the Company satisfies the Solvency Test, that is, since the definition of Solvency Test refers to valuations being able to be relied on, the implication is that a prudent director would have a valuation performed so that he may rely on the valuation when assessing the value of the assets and liabilities.

In the Example the parties are required to refer to the Solvency Test before and after each of the transactions contemplated other than the sale of the land and buildings where the Solvency Test is not required to be applied because it is not a major transaction and is not a dividend or distribution in terms of the Act since there is a bona fide sale.

D Practical Considerations Pertaining to the Solvency Test

What the Purchaser has to bear in mind is that creditors of the Company probably assess the financial position of a Company differently from the standard of the Solvency Test. Financiers and trading banks will apply discounting percentages to the asset values and to revenue items which means that the standard is higher than the solvency test - this is the nature of lending, that is, assessing the risk. In consequence, whilst a company may satisfy the solvency test per se, this may not satisfy a financier's security requirements. If the financiers are not satisfied with the Company, then the Company's cashflow and liquidity may suffer if, for example, the Bank reviews

and reduces its facility. In the Example, the Bank has increased its security cover by retaining the guarantee of the Vendors. The financier on the other hand, has not got the same protection although it retains title to the printing machine and the value of the machine is more than the amount required to settle the agreement. The financier is, however, not in the same position to adjust his security position unless there is a default or provisions for review under the hire purchase agreement

Existing trade creditors of the company have little recourse or checks upon changes in the control of the company. Change of share ownership in practice means little to a trade creditor. There is little ability for the trade creditors of a company to protect their position other than by seeking to regain title to the products supplied¹⁰⁰ and to keep the company within agreed credit terms. Solvency Test only provides protection if in fact it is breached at the time the particular distribution, dividend, repurchase or financial assistance is given.

¹⁰⁰ Under Romalpha Clauses.

XII DIVIDENDS AND DISTRIBUTIONS

The Vendors and the Purchaser determined that the Company should declare a dividend and repurchase shares as components of the deal. The Vendors would, however, have taken these steps in any event.

A *Dividend*

Negotiations had concluded on the basis that after the sale of the land and buildings, the Company would declare a dividend. Under the 1993 Act there is no restriction on the source of the dividend provided the solvency test is met. Historically there has been the limitation that dividends can only be paid from profits (including profits arising from revaluations). If the Company had not had sufficient profits to use up the Imputation Credit Account credit, then the dividend could have been sourced from traditional capital. In the Example, the Company has imputation credits available. In consequence, the Company declared a fully imputed dividend prior to settlement date so as to use up the available imputation credits in the Company.

The parties agreed that the dividend should be used to reduce or repay the Vendors overdrawn current account, in which case the Company's cash position remains the same but the value of the Company is reduced.

The post-dividend balance sheet of the Company is attached.¹⁰¹

101 Annexure 3.

B Purchase of Own Shares

The Purchaser and the Vendors agreed in negotiations that the Company would acquire some of its own shares and for this reason the Constitution which was adopted authorised the Company to do so.

The Company may purchase its own shares subject to, inter alia, the solvency test being satisfied, the Board resolving that the purchase is in the best interests of the Company and that the terms are fair and reasonable to the Company.¹⁰²

The conditions requiring to be satisfied before a share purchase is effected by the company are more onerous for the directors than simply declaring a dividend. Resolutions that the acquisition of the shares is in the best interests of the Company and that the terms are fair and reasonable to the Company increase the possibility of liability for the Vendors especially.

However, if the Vendors, that is, all the persons entitled to vote, agree then the foregoing procedure can be avoided other than that relating to the Solvency Test and the certificate.¹⁰³

Annexed is the Post repurchase Balance Sheet. The Company purchased 500,000 shares for \$705,000 with monies being credited as shown in the balance sheet. The Vendors agreed to the Company deferring payment of some proceeds until the next financial year.

¹⁰² Section 52 of the 1993 Act.

¹⁰³ Sections 86 and 86A of the 1993 Act.

XIII

FINANCIAL ASSISTANCE

The Vendors required security for the unpaid purchase moneys. The Vendors realised that a mortgage of shares would place them in the position no better than a shareholder on a winding up of the Company since the mortgage of shares would simply allow them to take possession of the shares. The Vendors required the Vendors' Debenture which has the benefit for the Vendors of promoting their claims against the Company to that of a secured creditor in priority to unsecured creditors, and enables the Vendors to receive full information on the Company's financial affairs and business and to appoint a receiver if the Purchaser and/or the Company fail to make payment.

Under Section 62 of the 1955 Act a company is prohibited from providing financial assistance to persons for the purpose of enabling those persons to buy shares in the company. The exceptions however include provision for loans or security to be given to or for the benefits of bona fide employees who may in the event of the company being a private company be directors as well.

However the parties chose not to seek to come within the proviso of Section 62 option since the timing did not suit them given that this was to be the last transaction which would occur once the Vendors had resigned as Directors and approved the assistance under the procedure in Section 86 of the 1993 Act.

In addition the shares were purchased by Nominee Company.

The Board must refer to the Balance Sheet of the Company to determine whether the solvency Test is satisfied. Annexed

is a copy of the Balance Sheet for the Company after the giving of financial assistance.¹⁰⁴

Ordinarily the Board must if it is to grant assistance where all shareholders have consented or for special assistance there must be a resolution that the financial assistance must be in the interests of the company and upon terms and conditions which are fair and reasonable.¹⁰⁵ However a company can give financial assistance other than by the procedures of Sections 61 to Section 63A provided the Solvency Test is satisfied and provided the procedure in Section 86 for approval by persons entitled to vote has been followed and approval given.

The solvency test in the Example is satisfied if the Company provides a security for purchaser bearing in mind that the assets exclude the amount of loans rovided, (which is nil because a guarantee is given) and the liabilities include the value of the security.¹⁰⁶

Attached is the balance after the giving of the FA which show a surplus of \$100,000.¹⁰⁷

XIV *DOCUMENTATION AND TIMETABLE*

The timetable and order of documents necessary to complete the Deal are set out in Annexure 7.

104 Annexure 5.

105 Section 61 to s 63A of the 1993 Act.

106 Section 86A(4A) of the 1993 Act.

107 Annexure 5.

XV CONCLUSION

A number of issues have been highlighted in the course of the paper which relate to the operation of the 1993 Act in the context of small companies.

The Act does provide a degree of flexibility for companies in relation to the management of their affairs and capital. However, the Act does require a number of procedural steps to be taken before particular procedures undertaken under the Act.

The 1993 Act has one central element, that is, the Solvency Test which is the test by which distributions, financial assistance and matters affecting the capital are gauged. The Solvency Test seeks to ensure that the company will maintain its capital so that it is in a position to pay creditors. The method by which the Act ensures that directors are conscious of the company's solvency is to make the directors liable in instances where the Solvency Test has not been met but where a distribution, financial assistance or reconstruction of capital has been effected.

In addition to the liabilities arising from the Solvency Test the 1993 Act also imposes and codifies various duties and responsibilities placed on the directors. In relation to a small company where the directors are often the owners of the shares and the employees, the duties incumbent upon the directors will be difficult to discharge by reasons of expense and the practicalities of actually complying with the various procedures. As a consequence, directors and shareholders of small companies may encounter difficulties with the penalty provisions under the Act as well as the liability issues arising from Solvency Test Certificates and general duties.

There are a number of conflicts within the Act which are difficult to reconcile. The most apparent is that which pertains to Section 86 and 86A of the Act. On the one hand the legislation seeks to empower shareholders to undertake various activities outside the procedures specified in other sections of the Act. Section 86A however then removes part of the effect of Section 86 by confirming that the Board must certify the company satisfied the Solvency Test and, by implication, the Board must approve the particular action.

There are, however, a number of positive points arising from the legislation and those are not to be understated. Financial information will be available to shareholders, directors will have to answer to shareholders and companies will have to operate in a more conservative fashion by reason of the liabilities imposed on directors or persons deemed to be directors.

The reforms effected by the 1993 Act modernise company law but in the writer's view it is likely that the 1993 Act will be reviewed and amended in the short term so as to overcome anomalies in the legislation which have been touched on in this paper and which will become more apparent in practise.

ANNEXURE 1

BALANCE SHEET AS AT 30 JUNE 1994

000s

SHAREHOLDERS FUNDS

Authorised and Paid Up Capital	1,500
Revaluation Reserve	600
Retained Earnings	305
Net Profit	120

2,525

Represented by:

CURRENT ASSETS

Debtors	485
Vendors Current Account	200
Stock	200

885

CURRENT LIABILITIES

Bank - overdraft facilities	100
Financier - HP	70
Sundry Creditors	300
Provisional Tax Paid	(60)
Holiday Pay	10
GST	20

440

WORKING CAPITAL

445

FIXED ASSETS

Land and Buildings	1,500
Plant and Equipment	1,780

3,280

TERM LIABILITIES

Financier - Printer hire purchase	700
Bank Term Loan	500

1,200

Net Assets - Assets

4,165

- Liabilities

1,640

\$2,525

ANNEXURE 2
POST SALE OF LAND AND BUILDINGS BALANCE SHEET

SHAREHOLDERS FUNDS	000s	Change
Authorised and Paid Up Capital	1,500	
Revaluation Reserve	-	(600)
Retained Earnings	205	(100)
Net Profit	120	
	<hr/>	
	1,825	(700)
	<hr/>	
Represented by:		
CURRENT ASSETS		
Debtors	485	
Vendors Current Account	500	300
Stock	200	
	<hr/>	
	1,185	300
	<hr/>	
CURRENT LIABILITIES		
Bank overdraft	100	
Financier HP	70	
Sundry Creditors	300	
Provisional Tax Paid	(60)	
Holiday Pay	10	
GST	20	
	<hr/>	
	440	
	<hr/>	
WORKING CAPITAL	640	
FIXED ASSETS		
Land and Buildings	NIL	(1,500)
Plant and Equipment	1,780	
	<hr/>	
	1,780	(1,500)
	<hr/>	
TERM LIABILITIES		
Financier - Printer	700	
Bank Term Loan	Nil	500
	<hr/>	
	700	500
	<hr/>	
Net Assets - Assets	2,965	
- Liabilities	1,140	
	<hr/>	
	1,825	(700)
	<hr/>	

ANNEXURE 3

POST DIVIDEND BALANCE SHEET

SHAREHOLDERS FUNDS	000s	Change
Authorised and Paid Up Capital	1,500	
Revaluation Reserve	-	
Retained Earnings	205	
Net Profit	-	(120)
	<hr/>	
	1,705	(120)
	<hr/>	
Represented by:		
CURRENT ASSETS		
Debtors	485	
Vendors Current Account	380	(120)
Stock	200	
	<hr/>	
	1,065	(120)
	<hr/>	
CURRENT LIABILITIES		
Bank overdraft	100	
Financier HP	70	
Sundry Creditors	300	
Tax Paid	(60)	
Holiday Pay	10	
GST	20	
	<hr/>	
	440	
	<hr/>	
WORKING CAPITAL	625	
FIXED ASSETS		
Land and Buildings	-	
Plant and Equipment	1,780	
	<hr/>	
	1,780	
	<hr/>	
TERM LIABILITIES		
Financier - Printer	700	
Bank Term Loan	-	
	<hr/>	
	700	
Net Assets - Assets	2,845	
- Liabilities	1,140	
	<hr/>	
	\$1,705	
	<hr/>	

ANNEXURE 4
POST SHARE RE-PURCHASE BALANCE SHEET

SHAREHOLDERS FUNDS	000s	Change
Authorised and Paid Up Capital	795	(705)
Revaluation Reserve	-	
Retained Earnings	205	
Net Profit	-	
	<hr/>	
	1,000	(705)
	<hr/>	
Represented by:		
CURRENT ASSETS		
Debtors	485	
Vendors Current Account	-	(380)
Stock	200	
	<hr/>	
	685	(380)
	<hr/>	
CURRENT LIABILITIES		
Bank overdraft	200	100
Financier HP	70	
Sundry Creditors	300	
Tax Paid	(60)	
Holiday Pay	10	
GST	20	
Balance of Vendors Re-purchase moneys	25	25
	<hr/>	
	565	125
	<hr/>	
WORKING CAPITAL	20	
FIXED ASSETS		
Land and Buildings	-	
Plant and Equipment	1,780	
	<hr/>	
	1,780	
	<hr/>	
TERM LIABILITIES		
Financier - Printer	700	
Bank Term Loan	-	
Vendor - share monies	200	200
	<hr/>	
	900	
Net Assets - Assets	2,465	
- Liabilities	1,465	
	<hr/>	
	\$1,000	
	<hr/>	

**ANNEXURE 5
POST FINANCIAL ASSISTANCE BALANCE SHEET**

SHAREHOLDERS FUNDS	000s	Change
Authorised and Paid Up Capital	795	(705)
Retained Earnings and Net Profit	205	
	1,000	(705)
 Represented by:		
CURRENT ASSETS		
Debtors	485	
Vendors Current Account	-	(380)
Stock	200	
	685	(380)
 CURRENT LIABILITIES		
Bank overdraft	200	100
Financier HP	70	
Sundry Creditors	300	
Tax Paid	(60)	
Holiday Pay	10	
GST	20	
Part of re-purchase price of Vendors shares	25	25
	565	125
 WORKING CAPITAL		
	20	
 FIXED ASSETS		
Plant and Equipment	1,780	
	1,780	
 TERM LIABILITIES		
Financier - Printer	700	
Bank Term Loan	-	
Balance of repurchase	200	200
	900	
Net Assets - Assets	2,465	
- Liabilities	1,465	
	\$1,000	

Note: For the Solvency Test purposes the full amount of \$900,000 is added to term liabilities and debted to shareholders funds so that the surplus of assets is \$100,000 over liability.

ANNEXURE 6

THE COMPANY LIMITED

SOLVENCY TEST CERTIFICATE

pursuant to Section 86A of the Companies Act 1993 ("the Act")

Proposed Action: Provision of Financial Assistance by the Company in connection with the purchase of shares in the Company.

Financial Assistance Requested: Issue of a second ranking debenture to Mr. and Mrs. V to secure the sum of \$900,000.00 as specified in an agreement for sale and purchase made between the Vendors and the Purchaser or his nominee, Nominee Co. Ltd.

Date persons entitled to vote consented to transaction under Section 86 of the Companies Act 1993.

The Board is satisfied that the power can be exercised because the Board is satisfied on reasonable grounds that the Company will immediately after the exercise of the power satisfy the Solvency Test (as defined in the Act).

We, the Directors whose signatures are ascribed below, voted in favour of the exercise of the power hereby record that in our opinion the Company will after the exercise of the power satisfy the Solvency Test.

.....dated

.....dated

ANNEXURE 7
DOCUMENTATION AND TIMETABLE

Prior to Settlement Date

- 1 Agreement for Sale and Purchase of Shares between the Vendors and the Purchaser. The Agreement would provide the various conditions (which would relate to the adoption of a Constitution to financial assistance for the Purchaser's Newco and re-registration) and representations, warranties and covenants pertaining to the shares, the financial and tax status of the business, the assets of the Company and the items required on settlement.

- 2 Application for Re-registration

- 3 Adoption of the Constitution which will need to authorise all transactions contemplated in the deal.

- 4 Agreement for Sale and Purchase of land and buildings made between the Company and Newco.

- 5 Deed of Lease between the Company and Newco.

- 6 Directors resolution authorising the sale of the land and buildings to Newco by the Company and the entry into a Deed of Lease with appropriate disclosure of interest by the directors (the vendors) in relation to their ownership of Newco.

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