APPENDIX A TO TIB NO. 11, JUNE 1990
DISTRIBUTIONS IN SPECIE UPON LIQUIDATION OR DISSOLUTION OF A COMPANY - INCOME TAX, STAMP DUTY AND GST IMPLICATIONS

CONTENTS

INTRODUCTION

The Department has been asked to clarify the implications under various Inland Revenue Acts of a distribution in specie to shareholders upon the liquidation or dissolution of a company ("distribution in specie"). This statement does not cover the distribution in specie of assets during the life of a company.

This statement is written in two parts. The first part sets out the various revenue implications of distributions in specie upon the winding-up of a company. The second part sets out in some detail the Commissioner's interpretation on several leading cases in this area which form the basis to the statement.

The statement on Goods and Services Tax is issued in substitution of the policy item issued in TIB No.4. The statement is essentially a repeat of the earlier statement. The main difference is that the item now covers the GST implications of an in specie distribution where a debt owed by a third party is taken over by the shareholder to whom the goods have been distributed.

PART 1

1. STAMP DUTY

1.1 A distribution in specie by a company to its shareholders of land or shares in a flat or office owning company (where section 24 of the Stamp and Cheque Duties Act 1971 ("SD Act") does not apply) upon a winding-up of that company or upon a dissolution of the company under section 335A of the Companies Act 1955, is exempt from conveyance duty as being an instrument of conveyance by a trustee to a beneficiary - section 17(f) of the SD Act. This only applies if the distribution is in the course of a winding-up or dissolution of a company.

1.2 However, if land distributed is of more value than that to which the shareholder is entitled, conveyance duty is payable on the excess value.

1.3 Where land is distributed in specie by a company to its shareholders upon a winding up or dissolution of the company, and the shareholders agree to assume liabilities owed by the company to the third parties, conveyance duty is payable on the amount of the liabilities assumed.

1.4 By contrast if debts owed to the shareholders to whom the property is to be distributed are not discharged before distribution in specie there are no stamp duty consequences.

2 GOODS AND SERVICES TAX

2.1 An in specie distribution may be made by a company that is not registered for GST purposes (and has never had a liability to be registered) or by a company that is (or was) registered for GST purposes, either before or after its registration is cancelled. Each situation is dealt with below. In each case the Department's position is that an in specie distribution is a supply of goods for GST purposes and that there is no consideration given by the shareholder in return for the goods.

In Specie Distribution by Company After GST Deregistration

2.2 Any goods forming part of the assets on hand relating to the company's taxable activity at the time of deregistration are deemed by section 5(3) of the Goods and Services Tax Act 1985 ("GST Act") to be supplied in the course of the taxable activity. The supply is valued in terms of section 10(8) of the GST Act. The value is deemed to be the lesser of the cost of the goods, including any GST, or their open market value.

2.3 Any subsequent supply by the company by way of in specie distribution does not have any GST implications for the company.

2.4 Even if the recipient is registered for GST purposes and the goods will be used in that person's taxable activity the recipient is unable to claim an input tax credit for those goods. The goods have not been acquired from a registered person. Therefore the provisions of paragraph (c) of the definition of "Input tax" in section 2 of the GST ACT must be met if a secondhand goods input tax credit is to be allowed. Under this paragraph input tax includes an amount equal to the tax fraction of the consideration in money for the supply to a registered person of secondhand goods situated in New Zealand. The amendment to this definition in the Goods and Services Tax Amendment Act 1989 requires there to be a supply by way of sale, and an in specie distribution is not a sale unless a debt owed to a third party is taken over by the shareholder to whom the goods have been distributed. Prior to the amendment, the proviso to the definition of "Input tax" would have excluded a claim as where the supplier and the recipient are associated persons the consideration in money is deemed to be limited to the lesser of the purchase price or the open market value of the supply. In the case of an in specie distribution there would not have been a purchase price (except where a debt owed to a third party was taken over by the shareholder).

Therefore the lesser of the two values would be Nil.

2.5 Where a debt owed to a third party is taken over by the shareholder to whom the goods are distributed an input tax credit will be able to be claimed to the extent of an amount equal to the tax fraction of the amount of the debt taken over.

In Specie Distribution by Company Before GST Deregistration.

2.6 The supply from the company to the shareholder is a supply to an associated person (this is a result of the trustee relationship that arises once the company is in liquidation, and the effect of the "associated persons" definition in section 2 of the GST Act). Therefore, if the recipient is not a registered person and the goods are not to be used in the person's taxable activity, the supply will be valued in terms of section 10(3) of the GST Act, i.e., the supply is valued at the open market value of the goods. This will determine the company's output tax liability.

2.7 When the supplier and recipient are registered persons and the goods are acquired by the recipient for the principal purpose of making taxable supplies, the provisions of section 10(3A) of the GST Act apply. The supply is valued at the consideration given (section 10(2) of the GST Act). In the case of an in specie distribution the consideration given by the shareholder is Nil so the supply has Nil value. The output tax liability and input tax deduction are Nil. However if a debt owed to a third party is taken over by the shareholder the consideration will be the amount of the debt taken over. The tax fraction of the amount of the debt taken over will be the output tax liability and the input tax deduction unless supply is the supply of a taxable activity as a going concern where the supply will be zero rated. As the supply is a taxable supply it cannot come within paragraph (c) of the definition of "Input tax".

In Specie Distribution by Company not Registered for GST (and not any time liable to be registered for GST purposes).

2.8 There are no GST implications for either party. If the recipient is registered for GST purposes, a secondhand goods input tax credit is not available for the reasons stated above at para graph 2.4 (in the absence of the recipient assuming liability for a debt owed to a third party where the consequences would be as in para graph 2.5).

3 INCOME TAX - DISTRIBUTION IN SPECIE FOLLOWING DEPRECIATION ALLOWANCE

3.1 Section 117 of the Income Tax Act (the "Act") provides that, where a taxpayer has been allowed a deduction in respect of the depreciation of any asset and that asset is sold for a price which exceeds the value to which it has been written down following allowance for depreciation, the excess (to the extent of the depreciation "recovered") is to be included in the assessable income of the taxpayer (subject adjustment if the asset has not been wholly used in the production of assessable income).

3.2 Where an asset in respect of which an allowance for depreciation has been claimed is distributed in specie it is deemed to have been sold at and to have realised its market price or if there is no such price a price determined by the Commissioner (section 117(5)(b) of the Act). Thus the difference between the written down value of the asset and the lesser of that market price and historical cost will be assessable income to the company.

3.3 Section 111 of the Act applies to a shareholder to whom an asset in respect of which depreciation has been allowed is distributed in specie. Section 111(1) provides that no greater deduction shall be allowed to the taxpayer acquiring the asset in respect of depreciation than would have been allowed to the person from whom the asset was acquired except where the proviso to section 111(1) applies or where the Commissioner exercises his discretion under section 111(2) of the Act.

3.4 Where any amount of depreciation allowed to the company which made the distribution in specie has been dealt with under section 117, the proviso to section 111(1) means that as of right the depreciation base of the shareholder in respect of the asset equals the sum of the depreciated value of the asset and the amounts dealt with under section 117. In most circumstances the Commissioner will exercise his discretion under section 111(2) and allow depreciation to be based on the market value of the asset as the Commissioner is not entitled to ignore the separate legal personality of a company, except in exceptional circumstances *Pioneer Laundry and Drycleaners Ltd v Minister of National Revenue* [1934] 4 All ER 254, 259.

4 INCOME TAX - TRADING STOCK AND LAND SALES

4.1 Where the trading stock of a company is distributed to any shareholder upon winding up, the

trading stock is deemed to have been sold by the company to the shareholder for:

(a) its market price at the date of distribution; or

(b) where there is no market price, at a price determined by Commissioner.

The proceeds of this deemed sale are included in the company's assessable income.

4.2 For the purpose of calculating the shareholder's assessable income, a shareholder is deemed to have purchased the trading stock at the market price or price determined by the Commissioner (section 197(2) of the Act).

4.3 Where and to the extent to which the market price or price determined by the Commissioner exceeds an amount which is or is equivalent to a return of share capital, such a distribution may be a dividend (section 197(3) of the Act). The consideration for a distribution in specie is nil (where there is no debt taken over by the shareholder). Thus the difference between nil and the market price will be a dividend unless it comes within any of the exemptions in section 4A of the Act. This is discussed more fully in paragraph 8.

4.4 For the purposes of section 197, "trading stock" includes any land where:

(a) the land falls within the definition of "land" in section 67 (1); and

(b) if the land were sold or disposed of, section 67 would apply to any profit or gain.

Where there is a distribution in specie of land which satisfies this "trading stock" definition, section 197 will apply and consequences will be as discussed in paragraphs 4.1 - 4.3.

5 INCOME TAX - SALE OF LAND WITHIN 10 YEARS OF ACQUISITION

5.2 Section 129 of the Act applies where certain land is "sold or otherwise disposed of" by a taxpayer within 10 years from the date of the taxpayer's acquisition of that land. Where land owned by a company is distributed in specie to a shareholder it is not "sold or otherwise disposed of" by the company. Section 129 is not triggered, therefore, by a distribution in specie upon a winding up or dissolution of a company.
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5.2 Where land is distributed in specie to a shareholder the date of the distribution is the "date of acquisition" of the land for the purposes of applying section 129 to the shareholder.

5.3 The purchase price of the land, for the purpose of applying section 129 to the shareholder on a subsequent sale if the shareholder has claimed any deductions for interest, for example, is the market value of the land as at the date of distribution.

6 <u>ACCRUALS</u>

6.1 Where a financial arrangement was acquired by a company for the purpose of sale or where the business of a company comprises dealing in such financial arrangements, and that financial arrangement is distributed in specie to a shareholder for no consideration (which will be the normal case upon a distribution in specie) or a consideration which is less than the market price or true value of the financial arrangement, the financial arrangement is deemed to have been sold for its market price at the date of distribution or, where there is no market price, for a price determined by the Commissioner (section 64J(3) of the Act).

6.2 The result of deeming the financial arrangement to have been sold is that the base price adjustment must be performed by the company in relation to the financial arrangement. The consideration for which the financial arrangement is deemed to have been sold is included in the base price adjustment calculation.

6.3 The shareholder is deemed to have acquired the financial arrangement for its market price or for a price determined by the Commissioner and this will be the acquisition price of the financial arrangement in relation to the shareholder.

7 <u>INCOME TAX - PROPERTY SALES AND POSITION OF SHAREHOLDER</u>

7.1 Section 65(2)(e) of the Act deals with the assessability of profits from personal property sales and profits and gains from profit-making schemes. Section 67 and section 65(2)(f) deal with the assessability of profits and gains from land sales.

7.2 It is recognised by the Commissioner that profits from the sale of property which has been acquired by a shareholder after a distribution in specie upon the winding-up or dissolution of a company will not, in the vast majority of cases, be acquired for the purpose of selling or otherwise disposing of the property. Nor will there normally be any question of there being a

profit-making undertaking or scheme in relation to the property. However, the first limb of section 65(2)(e) could apply as could the provisions of section 67(4), apart from sections 67(4)(a), 67(4)(b)(i), 67(4)(ba)(i) and 67(4)(c)(i) which will normally not apply unless the purpose of selling the property distributed was present at the time of purchasing the shares.

7.3 For the purposes of section 67 and for the purposes of section 65(2)(e) in relation to a shareholder to whom property has been distributed in specie, the date when that property was acquired is the date of the distribution in specie.

7.4 For the purpose of determining the profit or gain under section 65(2)(e) or under section 67 in respect of the subsequent sale or other disposition of distributed property by a shareholder, the market value of the property at the date of the distribution in specie is to be taken as the cost price to the shareholder (except in exceptional circumstances - for example, where shares in a company were acquired with the express purpose of liquidating the company, distributing the property of the company in specie and on selling that property, in which case the cost price of the property would be the purchase price of the shares).

8 INCOME TAX - DIVIDENDS

8.1 The value of an asset distributed in specie will prima facie be a dividend as the value of any property of the company distributed among all or any of the shareholders, to the extent that the market value of the property exceeds the consideration provided to the company by the shareholder for the distribution, is a dividend (section 4 (1)(c) of the Act). There is normally no consideration provided to the company by the shareholder for a distribution in specie unless the shareholder assumes liability for a debt owed to a third party in which case the consideration equals the amount of the debt taken over. There will also be no dividend to the extent that a debt owed by the company to the shareholder is cancelled.

8.2 Where an asset is distributed in specie on or after 1 October 1989 this is a “non-cash” dividend (section 2 of the Act). A non-cash dividend is deemed to be a fringe benefit (section 336N(8) of the Act), except where it comes within subparagraphs (ii) to (vii) of section 327B(2)(b) of the Act - e.g., most intercorporate dividends. Fringe benefit tax is payable in respect of it by the company. Imputation credits will normally not be able to be attached to non-cash dividends as they will generally be dividends arising in accordance with paragraphs (b) to (e) and (k) of section 4(1) of the Act.

8.3 Where the asset distributed in specie is a capital asset of the company the amount by which the asset’s value exceeds the sum of its cost to the company plus capital losses arising from the realisation of assets will not be a dividend (section 4A(1)(g) of the Act).

8.4 The value of an asset distributed in specie will also be excluded from the definition of dividend where the distribution comes within one of the other exemptions contained in section 4A such as being a return of capital or a distribution of a capital gain amount as defined.

The following is an example of a distribution of a capital gain amount. Section 4A(1)(f) provides that the term dividend does not include a capital gain amount distributed to a shareholder of a company upon the winding up of the company.

X Limited with an authorised capital of $100,000 purchased a building to derive rental income.

Authorised capital	$100,000	
Building (cost price)		$100,000

Several years later, following an approach from an unrelated party, X Limited realised the building for $500,000.

Authorised capital	$100,000	
Capital reserve	$400,000	
Cash		$ 500,000

X Limited subsequently purchased several assets.

Authorised capital	$100,000	
Capital reserve	$400,000	
Buildings		$200,000
Cars		$100,000
Airplane		$200,000

X limited went into liquidation and an in specie distribution of the assets was made to the shareholders. The issue for the shareholders is whether the distribution constitutes a dividend. It is considered that in this instance the distribution is excluded from the definition of “dividend”.

The in specie distribution in this case consists of two amounts.

- An amount constituting a return of share capital - authorised capital $100,000.
- A capital gain amount - capital reserve $400,000.

The fact that the capital reserve amount has been transformed from one form of asset (cash) to other assets (buildings, cars, airplane) does not alter the fundamental character of the amount distributed to the shareholders upon the wind-up. The character of the amount distributed remains a capital gain amount.

8.5 The practice of the Commissioner will be to treat any distribution in a winding up to be applied first in satisfaction of a return of share capital. Thereafter the liquidator may nominate from which fund the distribution is being made. In the absence of any such nomination each distribution will be treated, after the return of share capital, as having been made pro-rata from the company's various accounts.

PART 2

BACKGROUND

A. STAMP DUTY

1. The case of *Shaw Savill and Albion Company Ltd v Commissioner of Inland Revenue* [1956] NZLR 211 ("*Shaw Savill*") dealt with the question of stamp duty when property is distributed in specie to a shareholder on the liquidation of a company. The facts of the case are relatively straightforward. The respondent in the case had acquired all the shares in a company in 1947. In 1951 a resolution for the voluntary winding up of the company was passed and a liquidator appointed. The liquidator paid all the debts of the company and the respondent requested the transfer to it of the land owned by the company. A memorandum of transfer to the respondent of the land was duly executed. On presentation of the memorandum of transfer the District Commissioner of Stamp Duties ruled that it was assessable with stamp duty. The respondent objected to the assessment and required the Commissioner to state a case.

VOLUNTARY WINDING-UP

2. The Court of Appeal held that, once resolution had been passed for a voluntary winding-up of the company and the appointment of a liquidator and the liabilities of the company had been discharged, that company stood charged with the obligation of distributing the property of the company among the shareholders according to their rights and interests in the company (see section 293 of the Companies Act 1955). Where the articles or memorandum of association of the company permitted the property of the company to be transferred in specie to the shareholders and those shareholders became entitled to call upon the liquidator to transfer such property in specie, and did call for it, a relationship of trustee and beneficiary arose between the company and the shareholders.

3. Consequently it was held that the conveyance was exempt from stamp duty under the equivalent of section 17(f) of the Stamp and Cheque Duties Act 1971 ("SD Act") as being a transfer from a trustee to a beneficiary.

SECTION 335A COMPANIES ACT - DISSOLUTION OF SOLVENT COMPANIES

4. The question has arisen whether the situation in relation to stamp duty is any different where companies are dissolved under section 335A of the Companies Act 1955. This section provides an alternative procedure for dissolving solvent companies. In simple terms where a company has ceased to operate and has discharged all its debts and liabilities any officer or member may apply to the Registrar for a declaration of dissolution.

5. The Commissioner is not aware of any case law on this issue. However, it is considered that, in policy terms there should be no difference between a dissolution and a more formal winding-up. The dissolution process was intended only to provide a fast track procedure. Section 335A(6) is in the form of an empowering provision rather than a mandatory provision like section 293 (which deals with the winding up a company). Section 335A(6) provides that a company is *entitled* to distribute its surplus assets among its shareholders according to their respective rights rather than imposing a duty to so distribute. However, although section 293 imposes a statutory duty to distribute, it is not a statutory duty to distribute in specie. The trust relationship arises only where the shareholders have called for a distribution in specie. In a section 335A dissolution the shareholders also have the right to call for distribution in specie. For this reason it is considered that once the shareholders call for the distribution in specie it would be analogous to the section 293 position discussed above. A

trust relationship would equally arise. Any distribution in specie, therefore, upon the dissolution of a company is exempt from stamp duty under section 17(f) of the SD Act, as is any distribution under a winding up.

LIABILITIES AND DEBTS OWED TO SHAREHOLDERS OR THIRD PARTIES

6. *Shaw Savill* was a case where all of the liabilities of the company had been met and it was only a matter of distributing the assets to the sole shareholder. The more usual situation is where debts are still owing to shareholders or to third parties. The Supreme Court of Victoria examined such a situation in *Comptroller of Stamps (Vic) v Rylaw Pty Ltd* (1981) ATC 4411 ("Rylaw").

7. The following is a summary of the facts in the *Rylaw* case. A company in liquidation owed a large debt to its shareholders, the debts being owed pro rata in accordance with the number of shares held by each shareholder. All other debts of R Pty Ltd had been paid or provided for out of monies set aside for the purpose, except for a mortgage debt on a piece of land. The shareholders executed an agreement to which they were the only parties and by which they agreed that, as the debts owed to them by the company were in proportion to their shareholdings, the debts were thereby cancelled and that all the parties to the agreement would acknowledge to the company and its liquidator that the debts were cancelled. A second agreement was entered into between the shareholders and the company in which the acknowledgment was made. This second agreement also requested the liquidator to transfer to the shareholders in specie the mortgaged land. The liquidator executed a transfer by which the company transferred the land to the shareholders subject to the mortgage. The Comptroller of Stamps assessed duty on the first agreement as a deed of gift and assessed stamp duty on the transfer of the land on the basis that it was a conveyance on sale in which the consideration was the amount of the mortgage debt subject to which the land was conveyed.

DECISION

8. It was held that the transfer of land by the company to the shareholders was a distribution to the shareholders on the winding up of the company and was not a sale. It was held that the covenant implied under the Transfer of Land Act 1958 (Vic) that each transferee would indemnify the transferor against all liability under the mortgage over the land was not consideration for the transfer and did not transform a distribution in specie by a liquidator into a sale. The Comptroller advanced the argument that the agreement that the debts be cancelled was a gift. The Court held that, at the time of the agreement, the shareholders had the right to have the land sold, their debts paid from the proceeds (after payment of the mortgagee) and to have any balance paid over to them as shareholders. Under the agreement the shareholders had the right to have the land sold and the proceeds paid to them (after payment to the mortgagee) as shareholders or to have the land conveyed to them in specie subject to the mortgage. The position was exactly the same. There was thus no element of gift to the company.

APPLICATION

9. The Commissioner considers that the decision in *Rylaw* applies in New Zealand insofar as it relates to the matter of the cancellation of debts owed to the shareholders. The fact that there were debts owed to shareholders would not require conveyance duty to be paid where the property is distributed to the shareholders. The conveyance still comes within the exemption in section 17(f) of the SD Act. There would be no difference in the Commissioner's view, if debts owed to shareholders were not explicitly cancelled but the property was merely transferred to the shareholders.

10. The Commissioner considers, however, that *Rylaw* is *not applicable* to New Zealand insofar as it relates to the transfer of land subject to a mortgage not being subject to stamp duty. In the Commissioner's view the taking over a debt owed to a third party does constitute consideration for the transfer. In any event, there is no distinction in our present SD Act between a conveyance on sale and any other type of conveyance. Conveyance has a wide meaning and includes any type of transfer or assignment of any property by any means. Under section 10 stamp duty is payable to the Crown in respect of conveyances and leases of land and conveyances of shares in a flat or office owning company on every instrument issued on or after 17 March 1988 unless the conveyance is specifically exempted.

11. A distribution in specie upon the liquidation of a company is exempt from conveyance duty because of the trustee/beneficiary relationship that arises when the shareholders call for the distribution. However, it is only exempt from stamp duty to the extent that the shareholder is entitled to the property under the trust.

12. Under section 293 of the Companies Act 1955 a shareholder is entitled to the distribution of the property of the company only after payment of the liabilities. Consequently the Commissioner considers that a shareholder is only entitled under the trust to the property of the company after payment of the liabilities and not before payment of the liabilities. Thus conveyance duty is payable to the extent of the mortgage taken over. This view is consistent with the cases *Morrison v Commissioner of Stamps* (1907) 26 NZLR 1009 and *Drapery and General Importing Company of New Zealand Limited v Minister of Stamp Duties* [1925] GLR 58.

ACCRUALS

13. The Commissioner considers, on the basis of the *Rylaw* decision, that there would be no problems under the accruals regime in relation to any arrangement whereby such debts are cancelled. The following sets out the basis of this view.

4. A summary of the facts of the *Rylaw* case are set out in paragraph 7. It was argued that the agreement between the shareholders to discharge the debts owed to them by the company and that none of them would make a claim against the company for those debts was a deed of gift. The Court found that in order to be a gift there had to be an element of benefaction to the donee. However in this situation there was no such benefaction because there was an exact equivalence between the company's obligation to liquidate the land and, upon discharging all of the debts, to pay the balance to the shareholders and simply distributing the land to the shareholders without having to discharge the debts to them. Accordingly this arrangement was not a gift.

15. The accrual issue is whether the agreement between the shareholders to discharge debts owed to them by the company amounts to the remission of the financial arrangement. It is considered that in circumstances analogous to those in the *Rylaw* case there is no remission. The issuer (the company) has been discharged from making all remaining payments in relation to the debt owed. However that discharge was not "without fully adequate consideration". The facts of the case establish that the discharge of the debts enabled the company to make the distribution in specie of the mortgaged land. Furthermore it is clear that without the discharge the company would not have been able to distribute in specie. The land would need to have been sold in order to satisfy the debts owed to the shareholders. Accordingly the holders (the shareholders) have received adequate consideration from the issuer - the distribution in specie of the mortgaged land.

B. CONSIDERATION

1. Underlying much of the discussion in relation to distributions in specie upon the winding up or dissolution of a company is the question of whether there is any consideration by the shareholder for the distribution. The question is a very difficult one and one which has no clear answer. There are at least three lines of authority, all decided in different contexts:

(i) Consideration provided and received is nil;
(ii) Consideration is the purchase price of shares;
(iii) Consideration is the market value of the property distributed.

The Commissioner considers, however, that these lines of authority can be reconciled.

CONSIDERATION PROVIDED AND RECEIVED IS NIL

2. The leading case (*Shaw Savill*), which holds that a shareholder gives no consideration for a distribution in specie upon a winding up, was discussed earlier in the context of stamp duty. As *Shaw Savill* is a decision by the New Zealand Court of Appeal the Commissioner is bound by this decision. It is considered relevant in the context of GST, stamp duty, in calculating the amount of income tax payable by a company (where there are no statutory modifications) and in calculating the amount of any dividend received by a shareholder. It is to be noted that, as discussed in the context of stamp duty earlier, where a debt owed to a third party is taken over by a shareholder upon a distribution in specie, the amount of consideration for the above purposes will be the amount of the debt taken over.

CONSIDERATION IS THE PURCHASE PRICE OF SHARES

3. This line of authority is one which was arguably favoured by one judge in *Archibald Howie Pty Ltd and Others v The Commissioner of Stamp Duties (New South Wales)* (1948) 77 CLR 142 ("*Archibald Howie*") and by the majority in *Steinberg v FCT* (1975) 75 ATC 4221 ("*Steinberg*") in the special circumstances of that case. The Commissioner considers that taking consideration as the purchase price of the shares would apply only in limited circumstances. In particu-

lar for the purpose of ascertaining the cost price to a shareholder of property acquired on the distribution in specie upon a winding up of a company in circumstances analogous to those in the *Steinberg* case - i.e., where the shares of the company were acquired for the express purpose of placing the company in liquidation and on selling the property distributed.

CONSIDERATION IS THE MARKET VALUE OF THE PROPERTY DISTRIBUTED

4. This line of authority is relevant in most other circumstances when assessing the cost price to a shareholder of an asset if it is necessary to ascertain the cost price for the purposes of determining any profit or gain made on a subsequent sale by that shareholder. The cost price to the shareholder is normally to be taken as the market value of the property at the date of distribution. It is considered that any other approach would be inconsistent with the underlying purpose of the Income Tax Act - to tax income. Essentially any other approach would constitute a wealth tax where a taxpayer is taxed on the whole of the value of assets rather than on any changes in value of those assets. It may also lead to double taxation as at least some part of the amount distributed in specie could already have been treated as a dividend.

The various lines of authority are now examined in some detail.

CONSIDERATION PROVIDED AND RECEIVED IS NIL

5. In the case of *Shaw Savill*, the issue before the court was whether stamp duty was payable in respect of a distribution in specie or whether the distribution came within the exemption in section 81(d) of the Stamp Duties Act 1923 (now section 17(f) of the SD Act). It has been suggested that the *Shaw Savill* decision is not authority for the proposition that the consideration in a distribution in specie is nil. Shortland J., with whom the other two judges of the Court of Appeal agreed, held that section 81(d) applied only to "voluntary conveyances", defined in section 77 of the legislation as a conveyance of property otherwise than for valuable consideration. It was thus essential for the decision of the Court that section 81(d) applied only where the conveyance was otherwise than for valuable consideration. Thus it is implicit in the decision that the shareholder provides and the company receives no consideration upon a distribution in specie. The decision from the New Zealand Court of Appeal is binding on the Commissioner and therefore must be followed.

6. There are three circumstances where the Income Tax Act 1976 ("the Act") deems the consideration received by a company to be the market value of the property distributed

- where trading stock or land which would have been subject to section 67 is distributed (section 197);
- where property in respect of which a depreciation allowance has been claimed is distributed (section 117(5)(b) of the Act); and
- in certain circumstances, where financial arrangements are distributed (section 64J(3) of the Act).

Such sections are necessary as without them, no or a lesser consideration would be taken into account by a company.

CONSIDERATION IS THE PURCHASE PRICE OF SHARES

7. In the case of *Archibald Howie* the High Court of Australia had to decide whether, for the purposes of stamp duty, transfers to shareholders were transfers made upon a bona fide consideration in money or money's worth not less than the unencumbered value of the property conveyed.

In *Archibald Howie* the company, pursuant to a resolution for a reduction of capital which had been confirmed by the Court, returned capital to holders of paid up shares to the extent of 19/6 per £1 share by distributing in specie at the value in the company's books certain paid up shares in other companies. The actual value of these shares was considerably greater than the value showing in the company's books.

The Court held unanimously that the consideration provided to the shareholders was a consideration in money or money's worth of not less than the unencumbered value of the property conveyed.

This decision is a little confusing as the two judges who gave full written judgements differed slightly in their reasoning and the third judge agreed with them both.

8. Dixon J. found two respects in which a shareholder provides adequate consideration in money or money's worth for a distribution in specie upon a reduction of capital. (1) The first was that the distribution upon reduction of capital was an effectuation of the contract embodied in the articles of the company and a realisation of rights obtained by acquiring shares. The consideration given is the payment up of the share capital in satisfaction of the liability for the amount of the share incurred on

allotment (page 153). (2) The second respect in which Dixon J. found adequate consideration in money or money's worth was the reduction in the value of the shares held by the shareholder upon the reduction of capital (page 154). Thus, the consideration provided would equal the market value of the assets distributed.

9. Williams J. held that the amounts payable to a company upon subscribing for shares or the assumption of liability to pay for the shares provides full consideration of money or assets which the shareholder subsequently receives from the company. This has been taken as meaning (notably by Hutchison J. in *Shaw Savill*) that the amount of consideration equals the amount of the share capital.

   The third judge, Rich J, agreed with both Dixon J. and Williams J.

10. All three judges, however, held that the transfers to the shareholders were made upon a bona fide consideration of money or money's worth of not less than the unencumbered value of the property conveyed. It is considered that this means that even Williams J. held that the shareholder had provided an amount equal to the value of the shares distributed. The case of *Archibald Howie* was examined subsequently by the High Court of Australia in the case *Davis Investments Pty Ltd v Commissioner of Stamp Duties (New South Wales)* (1957-1958) 100 CLR 392. In that case the majority decided that *Archibald Howie* was not relevant to the facts before them but none of the judges threw any doubt upon the decision as such.

11. *Archibald Howie* was distinguished in *Shaw Savill* on the basis that it was a decision in the context of a reduction of capital rather than a decision in the context of a liquidation of a company. In *Shaw Savill* Stephen J. and Shortland J. found that, insofar as any consideration was to be found in the original purchase price for the shares the consideration was too remotely connected with the later transfer to allow it to be regarded as consideration for that transfer. Hutchison J. was attracted to the view that the consideration provided was the original share capital, even though in that case the original share capital was not provided by the shareholder who had purchased the shares from the original subscriber, but he was not prepared to dissent on that point.

12. Insofar as the consideration was found in the subsequent transaction itself, all three judges found that the same reasoning and results did not apply in the case of a transfer made in the course of liquidation. Shortland J. also referred to the difficulty of reconciling two English decisions of *Wigan Coal & Iron Co. Ltd v Revenue Commissioners* [1945] 1 ALL ER 392 and the case of *Associated British Engineering Ltd v Inland Revenue Commissioners* [1941] 1 KB 15 which indicates that he may not have come to the same decision as in *Archibald Howie* even if *Shaw Savill* had been a case in the context of a reduction of capital.

13. Another case where the cost of shares was held to be relevant is *Steinberg*. In that case the question was how to measure the profit or gain made by a shareholder upon the selling of land acquired upon the liquidation of a company. It was found as a matter of fact by the majority that the shareholder in question had purchased the shares in order to place the company into liquidation, to acquire the land held by the company and to sell that land . The majority judges Gibbs and Stephen J.J. held that the cost price, for the purpose of calculating the profit or gain, was the original purchase price of the shares. Gibbs J. held that the acquisition of the land was for the purpose of profit making by sale because the shares were bought to enable the purchasers to obtain the land with the main or dominant purpose of selling the land at a profit. Stephen J. did not consider that it was possible to accept such an analysis as the taxpayer bought only shares. In so doing the taxpayer received no land but only those rights to which a shareholder is entitled. He concluded, however, that there was a profit making scheme in relation to the purchase and that consequently the difference between the cost price of the shares and the sale price of the land was taxable to the shareholder in question.

14. Both Gibbs J. and Stephen J. however, indicated that in a normal case where the shareholder had not acquired shares with the purpose of liquidating the company and selling the assets which had been distributed in specie any cost price to the shareholder would be the market value of the property distributed. Gibbs J. states on page 4,233 that:

> "It is also true that since the distribution in specie was made in satisfaction of the rights of the shareholders, the "consideration" for the acquisition by the shareholders of the land from the company would be the full value of the land at the time of distribution."

   Stephen J. indicated also that it was the distribution in specie that would have been relevant had he not held that there was a profit making scheme (page 4,242). Thus, the view of the majority in the *Steinberg* case was that in normal case the cost to the shareholder will be the value of the asset at the date of distribution.

CONSIDERATION IS THE MARKET VALUE OF THE PROPERTY DISTRIBUTED

15. The third line of authority indicates that consideration upon distribution in specie is equal to the market value of the assets distributed. This view was favoured by at least one judge in *Archibald Howie* and by both judges in *Steinberg* if the requisite intention to liquidate the company and sell the land had not been present in that case. It was also favoured by Menzies J. in the case of *Federal Commissioner of Taxation v Williams* (1972) 3 ATR 283. ("*Williams*"). That case dealt with the question of whether a profit realised upon the sale of land acquired by gift was assessable. It was held that it was not. Menzies J. (pp 288-9) stated that it would be only in very special circumstances that land acquired by gift could be regarded as having been acquired by the donee for the purposes of profit by sale. If that was the case, however, he stated it would be the difference between the value of the gift when given and the price received upon sale that would be the profit which was subject to tax.

16. Another relevant case is a decision of the full High Court of Australia in *Official Receiver in Bankruptcy (Trustee Estate of William Fox, known as Rankin deceased) v FCT* (1956) 96 CLR 370. In that case the deceased had been reclaiming and selling certain low lying land according to a scheme approved by the Council and involving substantial expenditure. He died before the completion of the project and sometime after his death his executors, not having done any work in connection with the project, obtained an order for the administration of his estate in bankruptcy. The Official Receiver was appointed trustee. The creditors authorised the trustee to complete the project and the trustee proceeded with the work and subdivided and sold fully reclaimed allotments of land. The Commissioner of Taxation assessed the trustee for tax calculating that tax on the gross proceeds from the sale of the allotments with deductions for an amount calculated by an apportionment of the deceased's expenditure over the whole area and for the expenses incurred by the trustee. The trustee's objection to the assessment was disallowed and he appealed to the High Court. Webb J. submitted certain questions for the Full Court by way of case stated. It was held that the official receiver did carry out a profit making undertaking or scheme but that the basis for assessment was erroneous. The court said (page 384) that the official receiver was not in the same situation as the deceased. It stated:

> "If he has made a gain or profit in his capacity as trustee of Rankin's estate by the realisation of the assets that came to his hands, it must be because on a comparison, on the one hand, of the value of the assets and the condition in which they came to his hands when the order for administration of Rankin's estate in bankruptcy was made with, on the other hand, the net proceeds of sale after the deduction of all expenditure, it appears that owing to his activities there has been a real gain or profit."

Thus the difference between the market value of the land at the time it came into the trustee's hands and the sale proceeds which was to be brought to tax.

17. The approach taken in these cases is similar to that which seems to prevail where there is a gift of trading stock. The case of *Craddock v Zero Finance Co Ltd* [1944] 1 A11 ER 566 involved a fairly complicated company restructuring. The question was the value at which certain investments should be entered into the books of the company. Counsel for the Crown opened the argument with an analogy whereby he stated that, when a trader who receives by way of legacy an article of a kind in which he deals and brings it into his trading stock, the value at which it must be brought in is its market value, the reason for this being that the article not having been acquired at any cost to the trader, some basis other than cost must be taken and the only possible basis would be that of market value. It was argued that analogy applied to the case before the court. Lord Greene did not confirm the principle as it related to trading stock but stated that the analogy was totally misleading in the context of the case. The trading stock analogy was picked up again by Gibbs J. in *Curran v FCT* (1974) 5 ATR 61. The question in the case was the cost of certain bonus shares issued to an existing shareholder of a company. The shareholder was a share trader and argued that the cost to him was the paid up value of the shares received. The High Court of Australia upheld the taxpayer's contention. Two of the members of the Court were of the view that the shareholder had paid for the bonus shares by accepting the bonus issue in terms of the company resolution to issue them and thus the shareholder pays for the shares. By accepting the bonus issue the shareholder has agreed to the application to the capital of the company of the amount of the distributable profits so credited to the shareholder, thus effecting payment of the shares. Gibbs J., however, adopted the trading stock approach. He stated (page 82) that the appellant's trading accounts would not reveal shares which were in

fact valuable because the amount they would then show as income would include the value which the shares possessed when they were first brought into stock. He stated that the situation was analogous to that of a trader who takes into trading stock articles received by way of gift or under a bequest. Not allowing the articles to be brought in at market value would mean in effect that the trader would pay income tax on the value of the gift or bequest itself, which would not be the correct result. The approach outlined in these two cases is also consistent with the cases *Sharkey v Wernher* [1955] 3A11 ER and *Taylor v Good* [1973] 2 A11 ER 785.

C. TAXATION POSITION OF SHAREHOLDER ON SUBSEQUENT SALE

1. Section 67, section 65(2)(e) and section 129, for example, all require property to be acquired by a taxpayer before they operate. The Shorter Oxford English Dictionary gives two meanings of the word "acquire". The first is to "gain or get as one's own (by one's own exertions or qualities)". The second is to "receive, to come into possession of". Wilson J. in the case of *A G Healing & Co Ltd v CIR* [1964] NZLR 222, held that for the purposes of the predecessor to section 65(2)(e) the term 'acquired' connotes some positive step by the taxpayer which is absent from the passive receiving of an outright gift. Gibbs J. in *Williams* (page 291) also threw doubt upon whether a donee who passively receives property the subject of a gift can be said to acquire the property in the sense required for the purposes of the Australian equivalent of section 65(2)(e). However, in *McClelland v FC of T* (1970) 2 ATR 21 (*McClelland*) the Privy Council implied that it *was* possible for land to be acquired through the bounty of the testator but that in the circumstances of the case, it was not acquired with any purpose which was necessary for the equivalent of section 65(2)(e) to operate.

2. The Commissioner considers that the comments of the Privy Council in *McClelland* indicate that the meaning of the term "acquire" is not limited to acquisitions by a person's own exertions but extends to acquisitions where a person has come into possession of the land - for example upon a distribution in specie by a company to its shareholders.

3. Consequently, section 129, section 67 and section 65(2)(e) can apply to shareholders who receive property after a distribution in specie by a company. As discussed earlier, the purchase price or cost price to the shareholder, for the purpose of calculating any profits of gains, is to be taken as equal to the market value of the property at the time of distribution except in exceptional circumstances such as prevailed in *Steinberg*. The Commissioner recognises, however, that on the authority of *McClelland* and *Williams*, the second and third limbs of section 65(2)(e), sections 67(4)(a), 67(4)(b)(i), 67(4)(ba)(i), and 67(4)(c)(i) will normally not apply unless the purpose of selling the property distributed was present at the time of the purchasing of the shares.

APPENDICES TO TIB NO. 11, JUNE 1990