



## WEEKLY COMMENT: FRIDAY 20 SEPTEMBER 2013

1. Inland Revenue recently released the final version of Interpretation Statement IS 13/02 *Income tax – Whether certain rights conferred by the Companies Act 1993 could give rise to a “shareholder decision-making right”* (“IS 13/02”). It makes for interesting reading, particularly in relation to certain important aspects of the *Companies Act 1993* concerning actions affecting shareholders.
2. It is generally well known that various actions affecting shareholders, such as the issue of shares, payment of dividends, repurchase or redemption of shares, and the provision of financial assistance to purchase shares, are governed by specific provisions of the *Companies Act 1993* (“CA 1993”). Less well known is the fact that these requirements can be circumvented by the unanimous assent of all entitled persons under s. 107 of the CA 1993, subject to satisfying the solvency test as set out in s. 108.
3. Section 107 gives rise to the “rights” that are the subject of IS 13/02. So also are the rights conferred by s. 117 to restrict the company from actions that may adversely affect a shareholder interest group. The issue is whether these rights, that may be conferred on otherwise “non-voting” shares, could give rise to an effective voting interest that would be relevant in determining whether the requirements of the continuity provisions had been met.
4. The conclusion reached in IS 13/02 is that s. 107 and s.117 of the CA 1993 do not give rise to a shareholder decision-making right. The conclusion also applies to protective rights of a similar nature to those in s. 117 that are contained in a company constitution, the terms of issue of shares, options over shares or the NZX listing rules.

### **Voting rights and shareholder decision-making rights**

5. A person’s voting interest in a company is important when determining whether shareholder continuity requirements for carrying forward tax losses, grouping rules or tax consolidation rules, and rules for carrying forward imputation credits have been met. It is also important in determining whether a person and a company are associated, whether two companies are associated, and whether the control interest requirements for a company to be a CFC have been met.
6. Under s. YC 2 of the *Income Tax Act 2007*:

“A person’s voting interest in a company equals the percentage of the total shareholder decision-making rights for the company carried by shares or options held by the person.”

7. If decision-making rights carried by shares (or options) vary as between the four types of decision-making listed in the definition of “shareholder decision-making right”, the voting interest is the average of the differing percentages. A shareholder decision-making right is defined in s. YA 1 as meaning a right, carried by a share or option, to vote or participate in any decision-making concerning:
- (a) A dividend or other distribution to be paid; or
  - (b) The constitution; or
  - (c) A variation in capital; or
  - (d) The appointment of a director.
8. Three requirements of this definition are identified in IS 13/02:
- (a) The right must be “carried by a share or option: and
  - (b) The right must be a right to vote or participate in decision-making; and
  - (c) The decision-making must relate to one of the four subjects listed: dividends or distributions, constitution, a variation in capital and appointment of a director.

#### **Rights of some shares vs rights of all shares**

9. The primary section conferring rights on a share is section 36 of the CA 1993. Section 36(1) states that, subject to s. 36(2), a share in a company confers on the holder:
- (a) The right to 1 vote on a poll at a meeting of the company on any resolution, including any resolution to:
    - (i) Appoint or remove a director or auditor;
    - (ii) Adopt a constitution;
    - (iii) Alter the company's constitution, if it has one;
    - (iv) Approve a major transaction;
    - (v) Approve an amalgamation of the company under section 221;
    - (vi) Put the company into liquidation;
  - (b) The right to an equal share in dividends authorised by the board;
  - (c) The right to an equal share in the distribution of the surplus assets of the company.
10. Section 36(2) then provides that these rights may be negated, altered or added to by either:
- (a) The company's constitution; or
  - (b) The terms on which the share may have been issued:
    - (i) Under s. 41(b) following an amalgamation; or
    - (ii) Under s. 42 which permits the board to issue shares at any time to any person in any number; or

- (iii) Under s. 44 which permits the board to issue shares despite a limitation or restriction in the constitution, if approval for the issue has been obtained using the same procedure as approval for a change in the constitution; or
  - (iv) Under s. 107(2) which permits, if all entitled persons have agreed or concurred, an issue of shares without meeting the requirements of s. 42 or s. 44 or s. 45 (which provides for pre-emptive purchasing rights to existing holders of shares whose rights may be equalled or superceded by a new issue of shares).
11. Consistent with the above, s. 37 contemplates, subject to the constitution, the issue of different classes of share:
- (a) Redeemable shares; or
  - (b) Shares carrying preferential rights to distributions of capital and income; or
  - (c) Shares carrying special, limited, or conditional voting rights; or
  - (d) Shares carrying no voting rights.
12. Notwithstanding the above, some provisions in the CA 1993 confer rights on all classes of shares and the constitution or terms of issue of the share cannot negate these rights: for example, the right to attend meetings and comment on the management of the company. Such rights are not decision-making rights. There are, however, two other sections identified in IS 13/02 that confer rights that could be construed as shareholder decision-making rights.
13. Section 107 permits various requirements in the CA 1993 to be by-passed “if all entitled persons have agreed or concurred” in writing, including:
- (a) By-passing the requirements in s. 53 to pay dividends to all shareholders in a class equally; or
  - (b) By-passing the share repurchase rules in sections 59 to 65; or
  - (c) By-passing the share redemption rules in sections 69 to 72; or
  - (d) By-passing the rules in sections 76 to 80 relating to the provision of financial assistance by the company to purchase its shares; or
  - (e) By-passing the rules on directors’ remuneration in s. 161; or
  - (f) By-passing the rules relating to the issue of shares in sections 42, 44, or 45; or
  - (g) By-passing the rules in sections 140 and 141 relating to a transaction in which a director is interested.
14. The definition of an “entitled person” in s. 2 of the CA 1993 does not distinguish between a shareholder who is entitled to vote on a particular action and a shareholder who is not: an entitled person is essentially any shareholder in the company.
15. IS 13/02 includes a brief discussion on the history behind the enactment of s. 107. It is noted that the formalities imposed by the CA 1993 could be excessive insofar as smaller companies are concerned. The Law Commission stated that the section permits formalities required under the CA 1993 to be disregarded completely if all entitled persons agree on the informal action.

16. The other section that conceivably confers decision-making rights is s. 117, which provides the members of an “interest group” with the ability to approve or veto, by a special resolution of at least 75% of the affected shareholders, any particular action that would affect the rights attached to their shares, regardless of whether or not their shares carried any voting rights. These rights are of a protective nature and are contingent on the company’s actions: the company must call for a special resolution of the affected interest group.

**Whether s. 107 gives rise to a shareholder decision-making right**

17. The Commissioner considers that the mere existence of s. 107 and s. 117 does not give rise to any shareholder decision-making rights. The question is whether the sections give rise to a shareholder decision-making right when invoked.

18. The conclusion in IS 13/02 is that the rights conferred by s. 107 and s. 117 are rights “carried by” the shares. This is based on case law:

- (a) A share consists of a “bundle of rights and obligations” (*Borland’s Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279);
- (b) A right that is attached to a share can also be “carried by” that share (*Cumbrian Newspapers Group Ltd v Cumberland and Westmorland Herald Newspaper and Printing Co Ltd* [1987] Ch 1).

19. However, the Commissioner considers that s. 107 does not give rise to a shareholder decision-making right. Section 107 merely allows the company to by-pass various requirements of the CA 1993 in relation to certain actions. The decisions regarding those actions would first have to be made by the directors. Section 107 does not confer a right to participate in the decision-making regarding whether those actions should be taken. If, for example, approval to by-pass requirements is not obtained under s. 107, it would be still open to the directors to pursue the relevant actions by adhering to the requirements of the CA 1993.

**Whether s. 117 gives rise to a shareholder decision-making right**

20. The Commissioner considers that the definition of a “shareholder decision-making right” is capable of being given a broad or a narrow meaning. The broader interpretation would include protective rights conferred by s. 117.

21. The question of whether a “shareholder decision-making right” should be interpreted broadly or narrowly is discussed in the context of:

- (a) The legislative purpose of the definition of the term – in view of the Supreme Court’s support for a purposive approach in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22] to [24], and Blanchard J’s comments in *Stiassny v CIR* [2012] NZSC 106, [2013] 1 NZLR 453, that in most cases the only evidence of a provision’s purpose is the detailed wording of the provision, and therefore the safest method is to read the words in their “most natural sense”.
- (b) Whether an absurdity arises if rights set out in s. 107 and s. 117 are included in the definition – based on a number of cases, including *Frucor Beverages Ltd v Rio Beverages Ltd* [2001] 2 NZLR 604 (CA), which indicate that if the legislative purpose of the statute is clear, the court will strive to interpret legislation to avoid absurdity.

- (c) Which interpretation best accords with Parliament's purpose.
22. In terms of the legislative purpose of "shareholder decision-making rights", it is noted in IS 13/02 that the Commissioner considers that the term is meant to refer to substantive voting rights, and not merely protective rights (which may be included in the calculation of ownership using market value interests):
- (a) The meaning of a "shareholder decision-making right" is important for determining how a person's "voting interest" in a company is determined;
  - (b) The definition originated in the controlled foreign company ownership rules, which were focused on powers to receive or control the disposition of the company's income or capital, and consequently, on substantive rights to vote, and not on protective rights that are contingent on particular events and only temporarily give rise to rights;
  - (c) Certain instruments that confer no substantive voting rights – excluded fixed rate securities and excluded options - are specifically excluded from the voting interest calculations in s. YC 2.
23. Secondly, the Commissioner considers that including rights conferred by s. 107 and s. 117 in the definition of a shareholder decision-making right would lead to unworkable consequences. The protective rights only arise at certain times and the percentage of shareholder decision-making rights held by all shareholders would be affected at those times, with consequences affecting shareholder continuity, the associated persons rules and the CFC rules.
24. Thirdly, the Commissioner is of the view that the narrower interpretation of a "shareholder decision-making right" accords best with legislative intent. A person's voting interest in a company was not intended to include protective rights that are contingent and temporary in nature, and which might never arise. The Commissioner considers that the narrower interpretation is available on the words used in the definition.
25. Therefore, the Commissioner considers that the definition of a "shareholder decision-making right" does not include contingent rights of a protective nature covered by s. 107 or s. 117 of the CA 1993. The same conclusion applies to similar rights contained in a company's constitution, the terms of issue of a share, option over a share or the NZX rules.



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