Aspects of the preference share as a tool of estate planning

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James Willis surveys some reported cases in which preference shares have been utilised as part of an estate plan. His study highlights the potential pitfalls in using preference shares in this way. He nevertheless concludes that preference shares can be useful for estate planning in the New Zealand context.

I. INTRODUCTION

The most popular vehicle for estate planning activities within New Zealand is the trust structure, and because of the inherent flexibility that this structure possesses it will almost certainly continue to be the most used vehicle in future. The purpose of this paper is to examine certain aspects of the preference share as a tool of estate planning. This examination takes the form of a survey of some estate planning schemes extracted from reported cases in which preference shares have been utilised. There then follows a discussion of the implications of such schemes for the New Zealand estate planner and the potential uses of the preference share in the New Zealand context.

The preference share ordinarily entitles the holder to payment of dividends in priority to other classes of shareholder, or to a preference in repayment of capital or both. The rights of the holders of preference shares can and do vary considerably from company to company. The term "preference share" will be used throughout this paper to mean a share in an incorporated company (whether public or private) which gives to the holder some preferential rights. Among the various preferential rights that can attach to a preference share are —

(1) A preferential right to dividends at a fixed rate, non-payment in any year being accumulated into any succeeding year (cumulative preference shares).

(2) A preferential right to dividends as in (1), but dividends not paid in any year are not accumulated into succeeding years (non-cumulative preference shares).

(3) A preferential entitlement to capital on a winding up or liquidation (either or both).

(4) Voting rights disproportionate to total shareholding.

(5) Special rights to appoint directors.

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(6) A preferential right to dividends as in (1) and (2) and, after payment of an appropriate dividend to ordinary shareholders, a right of participation in profits thereafter.

If all or part of an estate is converted into a corporate structure and shares issued to the person wishing to control his estate, the issue of preference shares to that person could offer the following advantages —

(1) A preferential dividend entitlement giving the holder of the shares assurance of income and allowing any surplus income to be distributed to the other shareholders. This has the additional advantage of placing a limit on his income thus minimising his income tax burden.

(2) Depending on the principle adopted for the valuation of the preference share, the value of his interest in his estate can be frozen because the articles of the company can be drawn to prevent any major capital gain accruing to the preference share.

(3) The articles of association of the company can be drawn to give to the holder disproportionate voting rights and thus give control without complete ownership. For example, voting control to run the every day affairs of the company could be in the hands of the preference shareholder, whereas a power to liquidate the company could be achieved only by the preference and ordinary shareholders acting in concert.

However, it should be noted that the use of the preference share for estate planning is not without its disadvantages. For example the two-tier taxation of corporate income,[1] the possibility of adverse valuation by the Commissioner based on asset backing[2] and the effect of inflation on the fixed dividend,[3] could detract from its initial appeal.

1 In a limited context this double burden has been ameliorated by the introduction of "specified preference shares" in s. 194 of the Income Tax Act 1976.

2 The particular method of valuation used in respect of preference shares is of vital importance to their advantageous use in an estate plan. See generally on the valuation of shares Gray, "Aspects of Share Valuations for Duty Purposes" in Richardson (ed.) *Essays on the Estate and Gift Duties Act 1968* (Wellington, 1969) 236-302, where the various methods and the authorities are discussed.
Of the main broad methods of valuation discussed in that essay — capitalisation of earnings, capitalisation of dividends, and asset value — it is submitted that depending on the particular attributes of the preference shares concerned, the capitalisation of dividends or the asset value methods will be the most appropriate for the valuation of preference shares used as part of an estate plan. In particular, which of those two methods is used could depend upon the degree of control which the holder of the shares can exercise over the company. If the holder has the voting power to liquidate the company then asset value would probably be used.
There is little discussion in the cases on the valuation of preference shares. In *Gorton* v. *F.C.T.* (1965) 1 A.T.R. 65, 72 McTiernan J., in the lower court, used the asset value method without it being challenged. In *Grant* v. *F.C.T.* (1976) 7 A.T.R. 1, it was concluded by the High Court, without discussion, that the shares should be valued on a capitalisation of dividends basis. *Grant* is discussed infra in Part II.C of this paper. Note that the principles relating to the valuation of shares which were outlined by the Court of Appeal in *Hatrick* v. *C.I.R.* [1963] N.Z.L.R. 641, were cited with approval by the Court of Appeal in *Coleman* v. *Myers* [1977] 2 N.Z.L.R. 298.

3 As a result of this there has been a recent trend for public companies to provide their preference shareholders with the opportunity to convert their preference shares into ordinary shares.

II. REPORTED DECISIONS INVOLVING THE USE OF PREFERENCE SHARES FOR ESTATE PLANNING

The dearth of authority relating to the principles to be adopted when valuing preference shares has already been noted.[4] In New Zealand this absence of authority extends to cases involving the use of preference shares in estate plans. While *Tayles* v. *C.I.R.*[5] (which involved preferential fixed income entitlement from a unit partnership situation) was related to the present topic the substance of the decision concerned the income tax implications and was not directly relevant to estate or gift duty.

While practitioners in New Zealand do not appear to have been involved in litigation concerning estate plans using the preference share the same cannot be said of practitioners in other Commonwealth countries. Certainly in Australia, and to a lesser extent in Canada, the preference share as a tool of estate planning is well known and the legislature in those countries has taken steps to combat schemes involving the preference share. In this part of the paper it is proposed to refer to the various cases involving such schemes and to analyse the implications of those cases for New Zealand. In so doing it is convenient to group the cases into categories as different emphasis was placed within each category on the special characteristics to be gained from the preference share.

The first category illustrates how the control attributes of preference shares have been treated in the courts and the potential of such control attributes for estate planning in New Zealand. The second category of schemes deals with the so-called 'Gorton schemes' named after the spectacular estate planning success achieved by the forerunner of such schemes — *Gorton* v. *Federal Commissioner of Taxation.*[6] It will be suggested that such schemes cannot be safely pursued in New Zealand. The third category deals with a single case where the issue of preference shares for what appeared at face value to be appropriate consideration was argued as being for quite inadequate consideration. The last category and arguably the most provocative category for New Zealand estate planners, concerns schemes where the value of, or rights attaching to, shares held by the deceased are altered or converted on death.

A. Control of Companies through the use of Preference Shares

It has already been noted that where one shareholder controls a company the principles to be adopted when valuing his shares could be different from those adopted where such control is absent.[7] Thus control of 75% of the shares of a company can give rise to an asset-backing valuation because of the shareholder's power to liquidate that company. However, if that power to liquidate the company was not exercisable by the shareholders with a 75% share then a different value would be appropriate. Further, if the shares that carried this voting strength

4 Supra n. 2.
5 (1977) 2 T.R.N.Z. 115. For an analysis of this case see Bassett.
6 (1965) 113 C.L.R. 604; 1 A.T.R. 65.
7 Supra n. 2.

were preference shares and the holders were entitled only to the par value of their shares,[8] then an asset-backing valuation would also not be appropriate.

Thus in *Re Alex Russell*[9] the deceased sold land to a company in which there were only five ordinary shares. Consideration for the purchase consisted of the allotment of 20,000 preference shares of £1 each at a premium of £4.[10] The preferential dividend entitlement was eight percent but on a winding up the shares carried par value only. Prima facie therefore on the death of the deceased the shares could be worth only £20,000 and the capital gain on the land accrued to the ordinary shareholders.[11] But, during the lifetime of the deceased effective control of the company was retained by him through his control of the bulk of the issued shares and by certain rights given to preference shareholders in the company's memorandum of association.[12]

The Australian High Court decision of *Mendes* v. *Commissioner of Probate Duties*[13] emphasised another aspect of control of companies by preference shareholders. In that case the deceased was a shareholder in a company which had nine shares in total. The deceased held five of those shares and his son held four. However, in the period more than three years prior to the death of the deceased, the company issued 20,000 B shares to the deceased's son, which shares had the same rights as the other outstanding shares in the company except that the B shares were given voting rights in only limited circumstances. These limited circumstances included the right to vote where the company was to be wound up, the right to vote where the rights attaching to the Class B shares were to be varied and the right to vote where the company was contemplating a reduction of capital. It was the Commissioner's contention that the issue of shares by the company was a disposition by a company controlled by the deceased and that there was inadequate consideration.[14] It was further contended that the donee, the son, had not assumed bona fide possession and enjoyment of the shares more than three years before the death of the deceased and retained them to the entire exclusion of the deceased. His shares were therefore included in the estate of the deceased. The appellants stated that after the issue of the shares the company was no longer controlled by the deceased but admitted that before the issue it was so controlled.

The High Court unanimously rejected the arguments of the Commissioner. Kitto J. held that unless there were matters upon which the B shareholders could vote, it remained true that for all other matters before a general meeting, decisions of the company would be made by the holders of the majority of the ordinary shares, that is to say by the holder of the deceased's shares. The learned judge briefly traversed the rationale behind section 7 of the Probate Duty Act 1962

8 For a general discussion see O'Loughlin "Taxplanning a Family — Control Without Ownership?" (1973) 47 A.L.J. 480.

9 [1968] V.R. 285.

10 Cf. *Grant* v. *F.C.T.* (1976) 7 A.T.R. 1, 14 and see the discussion at Part II.C infra. It would appear that in *Re Alex Russell* the consideration for the allotment was not inadequate as was the case in *Grant* because of the options involved.

11 There were other significant issues involved in this decision concerning the option possessed by the shareholder to convert his preference shares to ordinary shares.

12 Supra n. 9 at 295-296.

13 (1967) 122 C.L.R. 152.

14 The provision relied on was s. 7 Probate Duty Act 1962 (Victoria).

(Victoria). He noted that the deceased had reserved to the directors of the company extensive control without the necessity of going before the general meeting but stated[15] that decisions of the Board of Directors were decisions *for* the company not decisions *by* the company and only decisions of the company in general meeting were decisions by the company. He then discussed the English authorities on the subject of what was meant by the term "control of a company" and he accepted the words of Rowlatt J. in *B. W. Noble Limited* v. *Inland Revenue Commissioners:*[16]

> 'Controlling interest' is a phrase that has a certain well known meaning; it means the man whose shareholding in the Company is such that he is the shareholder who is more powerful than all the other shareholders put together in General Meeting.

Kitto J. also quoted the words of Lord Reid in *Barclays Bank Ltd* v. *Inland Revenue Commissioners*:[17] "No-one doubts that control means voting control — control by the majority of votes at a general meeting".

As to the particular facts, Kitto J. concluded[18]

> If in the general meeting one person has the majority of votes on some subjects and another has the majority of votes on other subjects, neither can truly be said to control the company. The control is divided between them.

He then said, with reference to section 7:

> The deeming provisions of s. 7(2)(b) are expressed to apply, not where a company was partially controlled by the deceased, or was controlled by him in respect of most topics, or in respect of the most important topics or those of most common occurrence, or even all topics that might relate to the ordinary operation of the company as a going concern, but where it is controlled by the deceased — controlled by the voting rights of the deceased in no less than the whole of the possible agenda of a general meeting . . . [T]o draw a line with clarity would be exceedingly difficult, and the legislature has not attempted to do it. Only the case where control by the deceased has been absolute is provided for.

Therefore, Kitto J. held that the shares sought to have been included in the estate of the deceased by the Commissioner should not have been. Taylor J. agreed with the reasons of Kitto J. and briefly added his own reasons. Windeyer J. reached a similar conclusion.

In *The Minister of Finance of British Columbia* v. *Mann Estate*[19] the Minister of Finance of British Columbia sought to add a premium to the value of preference shares which had sufficient voting strength to control the company. The facts were that the deceased incorporated a holding company to hold various stocks and bonds and similar investments. The capital of the company was divided into 1,000 shares, there being two classes of share. The deceased held ten Class B shares with a par value of $1.00 which shares also had the only voting rights in the company. There were an additional 990 Class A shares which also had a par value of $1.00. Upon the death of the deceased, his executors valued the deceased's shares at one percent of the company's net worth. The method of valuation used was a liquidation approach which in the circumstances would

15 Supra n. 13 at 160.

16 (1926) 12 T.C. 911, 926.

17 [1961] A.C. 509, 526.

18 Supra n. 13 at 165.

19 [1973] C.T.C. 561 — affirmed in the Supreme Court [1974] C.T.C. 222.

appear appropriate. That method of valuation was not challenged by the Minister of Finance. However, the Minister of Finance purported to increase the value of the Class B shares on the following basis. It was argued that a purchaser of the Class B shares would have taken over all the voting rights in the company and would have been able to ensure the carrying of resolutions in his favour enabling himself to charge an administration fee on the assets of the company. The Minister of Finance sought to add this administration fee to the value of the shares.

The court held that there was no evidence to support the Minister's contention. Because the market value of the shares was their liquidation value, no premium could be placed on the control aspect that was possessed by the shares. The corporate unit in *Mann* was in reality merely a holding company and there was no apparent argument that the shares should be valued upon the basis of a notional liquidation. The argument here was whether the control attributes of the Class B shares entitled the addition of a premium to their value to recognize an advantage that would be obtained by a new Class B shareholder.

The New Zealand Estate and Gift Duties Act 1968 attaches special significance to controlled companies in sections 23 and 65. Section 23 is concerned with the valuation of debts due to the deceased. Where debts are owed by relatives (s. 23(2)(a)) controlled companies (s. 23(2)(b)) or trustees (s. 23(2)(c)) no discount on the basis of present value calculations is permitted. "Controlled company" is defined in section 23(1).[20]

Section 65 is concerned with dispositions of property for inadequate consideration by controlled companies and the section deems such dispositions to have been made by the controlling person. The definition is wide and includes companies controlled " . . . by or on behalf of any one person . . . whether directly or indirectly and whether through holding a majority of shares in the company or in any other manner whatever". Gifts that fall within the definition will be included in the notional estate of the 'controlling person' if they are made within three years of his death.[21]

It should be noted that these sections do not authorise the addition of any premium to the value of shares on the basis of their control attributes. Thus a large concentration of control in a minority holding does not increase the value of that holding beyond the value ascertained on the normal principles of valuation. The decision in *Mann* supports this.

What are the implications of the foregoing? It is submitted that the preference share represents a means of controlling assets subject to capital gain without actually owning those assets. If the preference shares confer on the holder the right to liquidate (i.e. more than 75% voting control) but where on a liquidation they are entitled to par value only the holder can both control the company and escape the duty consequences of ownership. In *Minister of National Revenue* v. *Estate of M. I. Smith*[22] and *Estate of A. W. Beament* v. *Minister of National*

20 See the discussion as to what is meant by 'control' in this section in *Adams and Richardson's Law of Estate and Gift Duties* (5th ed, Wellington, 1978) 157 et seq.

21 Section 10. See generally Richardson (ed.) *Essays on the Estate and Gift Duties Act 1968* (Wellington, 1969) 168-175 and 76-77.

22 [1975] C.T.C. 335.

Revenue,[23] the company articles were drawn so that while the deceased was alive his shares had a full income entitlement and full voting strength but there was a collateral agreement to wind up the company on death and on a winding up those shares were entitled to receive their par value only. In case the Minister attempted to argue that by use of voting strength the preference shareholder could have altered the rights attaching to the preference shares there was a clause in the articles prohibiting variations of the rights attaching to the shares unless sanctioned by two thirds of the members of each class. It was a scheme that successfully enabled the deceased to enjoy the income from shares in a company,[24] to control the investment decisions of the company and otherwise enjoy the benefits incidental to ownership without attracting estate duty.

If maintenance of income enjoyment is not desired but control is, preference shares with a nominal preferential dividend entitlement but disproportionate voting rights would have the same effect (on the understanding that the preference share is worth its par value only on winding-up).

Not every person wishing to establish an estate plan can have their affairs arranged to take the benefits that accrue from such schemes. Essentially there must be a need to retain the privilege of limited liability[25] and a particular desire to retain control. But given those circumstances, which it is submitted are not unusual, then the preference share can offer real advantages. It is to be noted that there may be difficulties associated with the act of alteration of rights attaching to shares. These difficulties are discussed later in more depth.[26] Further, the control advantages that can be achieved by preferential share voting rights do not always obviate the need to gift property as part of the divestment of ownership process.[27]

B. *"Gorton" Schemes: Diminishing Estate Value by Conversion of Ordinary Shares to Preference Shares*

In 1965 a case came before the High Court of Australia concerning a complicated series of transactions entered into by a Mrs Abel, which had the result of reducing her estate considerably. The court concluded that there were no gift or estate duty consequences arising from the transactions. The considerable estate duty saving achieved by the scheme prompted two further reported attempts to emulate the success achieved by Mrs Abel's advisers.

The 1965 case was *Gorton* v. *Federal Commissioner of Taxation*[28] and it involved the following transactions. After consultations with her solicitor and accountant Mrs Abel incorporated two private companies of which she was a director. Each company purchased from Mrs Abel public company shares for which full consider-

23 [1970] C.T.C. 193 and discussed further at Part II.D infra.

24 The main assets of which being shares in public companies any dividends received were free of income tax.

25 For example, where the principal assets are shares in a trading company.

26 Infra Part II.D.

27 The *Gorton* schemes involved the conversion of ordinary shares to preference shares (worth after conversion much less than ordinary shares) but subsequent share issues were for inadequate consideration. See infra Part II.B.

28 (1965) 113 C.L.R. 604.

ation was credited to Mrs Abel in the books of the company. Thereafter the company after application by Mrs Abel allotted to her ordinary shares at a premium and the consideration for this allotment was debited against her account in the books of the company. Resolutions were then passed converting her ordinary shares into cumulative preference shares, such shares carrying a preferential dividend entitlement of 6% together with a priority of return of capital upon a winding up but with no entitlement beyond par value of the shares. Immediately after this, at a further meeting of the directors of the company, it was resolved that pursuant to an application by one R. C. Crebbin (a nephew of Mrs Abel), ten ordinary shares would be allotted to Mr Crebbin. Similar steps were taken in the case of the second company incorporated by Mrs Abel and ten ordinary shares in that company were allotted to another nephew, T. G. Crebbin. In both cases the effect of the allotment was to vest in the nephews shares worth a great deal more than they paid for them. Shortly thereafter, and quite unexpectedly, Mrs Abel died.

It was quite clear that the preference shares to which Mrs Abel's estate was beneficially entitled were worth significantly less than the ordinary shares. The Commissioner however, assessed Mrs Abel's estate upon the basis that she had made a disposition of property in the period three years prior to the date of death, that the disposition of property could therefore be ignored, and the value of the shares transferred to the two private companies included in her estate. The Commissioner's argument was founded upon section 4(1)(f) of the Gift Duty Assessment Act (Commonwealth) which included in the definition of a disposition of property:

> (f) . . . any transaction entered into by any person with intent thereby to diminish directly or indirectly the value of his own property and to increase the value of the property of any other person.

All four Judges who delivered judgments in the case agreed that there was a transaction entered into by Mrs Abel within the meaning of section 4(1)(f). However, Barwick C.J. and Taylor J. considered that the question that was to be resolved was whether in each case the intended effect of the transaction was to diminish the value of Mrs Abel's property and to increase the value of her nephews' property. They concluded:[29]

> But it is, we think, impossible to say that the value of either nephew's property was increased as a result of the transactions. The effect of each transaction was that in return for the expenditure of £100 each nephew became entitled to 10 shares of a total value far in excess of the amounts expended by them. But it cannot be said that the effect of the transaction was to increase the value of their property; its effect was to vest in each of them, in return for an expenditure of £100 each, 10 shares which at the moment of acquisition were of great value. There was no moment of time when any change in the value of the shares in the hands of the nephews took place. All that can be said is that the transaction into which the deceased entered ensured that when the nephews acquired the property in the shares, they should have a value beyond the actual consideration which the nephews would pay for them.

Windeyer J. in a strong dissenting judgment said[30]

> At two o'clock on 19 May 1960, Mrs Abel was a woman of considerable wealth.

29 Ibid., 623-4.

30 Ibid., 625.

Fifty minutes later she was not as well off as she had been, and each of her nephews was better off than he had been. That means, it seems to me, that the value of Mrs Abel's property had been diminished and the value of the property of her nephews had been increased.

The learned Judge equated the use of the word property in paragraph (f) with the word estate. He then cited the statement in the judgment of Latham C.J. and Webb J. in *Grimwade* v. *Federal Commissioner of Taxation*:[31] "Paragraph (f) is intended to cover cases of transactions entered into with the intent to diminish the value, . . . of the donor's own property *in globo* and to increase the value of the property *in globo* of another person."

Thus if as the result of a transaction one person is worse off and another person better off than they would have been if the transaction had not occurred and if the transaction was entered into with intent to produce this result Windeyer J. considered the statutory description satisfied. The decision of the High Court of Australia in *Roy Palmer* v. *Commissioner of State Taxation*[32] supports the view of Windeyer J. The case was an appeal against an assessment made under section 74(1) of the Administration Act (W.A.). In the Supreme Court of Western Australia Jackson C.J. had said:[33] " . . . the steps taken in the case before me are in substance indistinguishable from those in *Gorton's* Case . . . "

Mason J. in the High Court agreed with that assessment of the facts[34] and gave the principal judgment. It was not disputed in the High Court that the various steps taken amounted to a transaction for the purposes of the Act. The crucial issue was whether the use of the word 'estate' in the Administration Act gave rise to a different interpretation from the word 'property' used in the Gift Duty Assessment Act — the Act applied in *Gorton.* Mason J. held:[35]

It is unnecessary to embark on a discussion of the conflict of opinion between the majority and Windeyer J. in *Gorton's* Case. It will suffice for me to say that the use of the word 'estate' in s. 74(1)(b) in lieu of 'property', taken in conjunction with the other differences in language which I have noted, enables us to distinguish *Gorton's* Case. The majority judgment turns in my opinion, as I have said, largely, if not wholly, on the presence of the word 'property' and the significance which their Honours appear to have attributed to it. The presence of the word 'estate' in the statute now under consideration deprives that judgment of persuasive influence in this case and makes the judgment of Windeyer J. so much more apposite.

A slightly different question arose in the case of *Ord Forrest Pty Ltd* v. *Federal Commissioner of Taxation.*[36] The matter at issue was referred to by way of a final observation of Windeyer J. in *Gorton*:[37]

It seems that the view of the facts of this case taken by the other members of the Court leaves open the question whether, there being no disposition of property by Mrs Abel to her nephews, there were not gifts by the companies to her nephews. But that question does not arise on this appeal.

The facts in *Ord Forrest* were similar to those in *Gorton.* The Commissioner considered that the allotment of the ordinary shares by the company to the

31 (1949) 78 C.L.R. 199, 215.
32 (1976) 7 A.T.R. 22.
33 (1975) 5 A.T.R. 666, 670.
34 Supra. n. 32, at 25.
35 Ibid., 27.
36 (1974) 4 A.T.R. 230.
37 Supra. n. 28, at 627.

applicants, after the resolution converting shares to preference shares had been passed, was a dutiable gift because there was an inadequacy of consideration paid by the applicants to the company for the ordinary shares. This view was upheld at first instance by Stephen J.[38] who held that the allotment of shares by Ord Forrest Pty Ltd fell within the definition of a disposition of property and that the consideration paid for the disposition was inadequate. On appeal to the Full Court that Court was evenly divided. Barwick C.J. and McTiernan J. decided for the company (McTiernan J. gave no reasons but agreed with the Chief Justice), Gibbs J. and Mason J. for the Commissioner. In the result therefore the Commissioner was successful.

In the course of his judgment the Chief Justice conceded that:[39] "The overall purpose of [the transactions] along with the allotment of the eight shares is apparent enough but, in my opinion, irrelevant to the precise question which arises for decision in this case". The substance of the Chief Justice's decision was:[40]

> A company in allotting a share in its capital does not sell or transfer the share. Having its capital divided into shares of a nominal or par 'value', it allots a share to an applicant therefore on payment of a sum of money. In no sense, in my opinion, is there a transfer or alienation of property by the allotment . . . The company does not part with any property, though by the allotment it diminishes its capacity to continue to allot shares: i.e., it reduces the amount of its unissued capital. But, of course, taking suitable steps, it may increase that capital. When it does so, it does not increase its property any more than it diminishes its property when it allots a share.

Accordingly the Chief Justice concluded that there was no 'disposition of property' by the appellant company.

Gibbs J. considered that there was a 'disposition of property' within the meaning of the definition in the Gift Duty Assessment Act but implicitly agreed with the Chief Justice that an allotment of shares cannot be described as a disposition of property in the ordinary meaning of that expression. In a lengthy judgment he dealt with each of the appellant's submissions and rejected them. Mason J. reached a similar conclusion.

The importance of this decision is that it illustrates that the expression 'disposition of property' as defined in the Gift Duty Assessment Act is given an extended interpretation to embrace situations not normally within its meaning.[41] The arguments raised attempted to point to anomalies arising from the interpretation but Gibbs and Mason JJ. effectively considered these anomalies more imagined than real.[42]

If there were ever any doubts as to the success of a *'Gorton'* scheme if implemented in New Zealand they have been put to rest by the decision in *Palmer*'s case. In the writer's opinion the approach adopted by Windeyer J. in *Gorton*'s case and endorsed in *Palmer* would undoubtedly be followed in New Zealand for two reasons:

38 (1973) 3 A.T.R. 561. 39 Supra. n. 36, at 231. 40 Ibid., 233.

41 The equivalent New Zealand section gives the same result. See *Carmody* v. *C.I.R.* [1975] 1 N.Z.L.R. 118.

42 Supra n. 36. Gibbs J. at 239-242, Mason J. at 243-244.

(1) It is submitted that the reasoning of the majority in *Gorton's* case is somewhat strained and is not as persuasive as the reasoning adopted by Windeyer J. This view has been repeated elsewhere:[43]

> The actual decision in *Gorton's* case seems somewhat doubtful, since s. 4(1)(f) of the Gift Duty Assessment Act, 1941-57 (Commonwealth) included in the definition of gift 'any transaction entered into by any person with intent thereby to diminish, directly or indirectly, the value of his own property and to increase the value of the property of any other person'. This seems to describe exactly what Mrs Gorton (sic) did. However, two of the three Judges of the High Court of Australia relied on the fact that at the time she converted all her ordinary shares into preference shares, there were no other outstanding shares and her nephews did not acquire their shares until ten minutes after conversion. This reasoning seems rather thin; . . .

(2) The relevant word in the *Gorton* case which was relied upon by the majority was the "property" of any person. The New Zealand section specifically refers to the "estate" of any person and the use of this word clearly has a much wider import than the gloss placed on the word "property" by the majority in *Gorton,* as shown by *Palmer*[44]. Furthermore, as section 2(2) of the New Zealand Act is expressed in a similar way, *Ord Forrest* is, it is submitted, conclusive authority for the view that a company allotting shares to applicants for less than full consideration would not itself escape gift duty.

C. The Issue of Preference Shares at Par Value

The value of preference shares at the time of issue and the appropriate consideration payable by a subscriber on allotment was the subject of the most recent Australian decision regarding the use of preference shares in estate plans. The case was *Grant* v. *Federal Commissioner of Taxation.*[45] The appellant Grant applied for and was allotted 97,000 C Class preference shares of $1.00 each in Winifred Pty Limited. The shares had a non-cumulative preferential dividend entitlement of 4% and had the usual priority as to capital on a winding up but had no further entitlement in the profits or assets of the company. For this allotment Mrs Grant paid to the company $97,000. But as Jacobs J. said:[46]

> The shares, after they were issued were, on a profit or earnings basis calculated upon the dividend payable, worth $39,770, each share being worth 41c. On a liquidation basis these shares were worth their face value, $97,000.

The Commissioner assessed Mrs Grant for gift duty in respect of the inadequacy of consideration received by Mrs Grant. Several questions were required to be answered by the court and in essence they were:
(1) Was the payment by Mrs Grant in return for the allotment a disposition of property?
(2) If so, was the consideration adequate?
(3) Was the Commissioner's valuation appropriate?

Stephen J. said[47] with regard to the C Class shares:

43 Wolfe D. Goodman Q.C. "Use and Valuation of Preference Shares Where Rights Reduce on Holder's Death", (1977) 3 Estates and Trusts Quarterly 332, 340.
44 See too Windeyer J. in *Gorton* (supra) at 626.
45 (1976) 7 A.T.R. 1.
46 Ibid., 7.
47 Ibid., 2.

> They were shares which, from the moment of their creation, were destined to be worth much less than their nominal amount and for which no ordinary investor would have considered paying that nominal amount.

The appellant's argument was that as a matter of Australian company law, Mrs Grant could not have paid any less for her allotment, it being prohibited to issue shares at a discount. Stephen J. rejected this argument saying that to so argue would add an impermissible gloss on the wording of section 4. His Honour commented:[48]

> The nominal amount of a share may have some bearing on the share's value as, for instance, when winding up is in prospect, but will otherwise say nothing as to its value, which will depend upon supply and demand as manifested in whatever market place is available for dealings in the shares of the particular company in question. . . . The fact that it would have been unlawful for the company to have allotted the shares to Mrs Grant had she not paid or assumed liability to pay an amount equal to their nominal amount, an amount which was more than twice their worth, may say much as to those responsible for the creation and issue of the shares but tells one nothing about the adequacy of the consideration received by Mrs Grant.

Mason J. reached the same conclusion, also holding that the shares should be valued on a dividends basis.

Jacobs J. said that if the appellant's contention relating to Mrs Grant having paid the minimum amount permitted by law were to be accepted, then when prices and rents were controlled the person paying rent or prices at the controlled level may by so doing give less than adequate consideration. Jacobs J. thought that this was "unreal".

As already indicated, this case supports the view that preference shares should be valued on a dividends basis and the report indicates no argument being put forward as to any alternative appropriate argument for the valuation of the preference shares issued to Mrs Grant. Had the shares been valued for estate duty purposes a liquidation value may have been more appropriate as in *Mann, Smith* and *Beament*.[49]

There is no principle of valuation that has been adopted in New Zealand that would give rise to a different conclusion from that reached by the High Court in *Grant*. The substance of the appellant's contention was that where shares cannot be issued at a discount by reason of law then where the full par value of the shares is paid then there can be no gift. The flaw in this argument is that the subscriber for the shares should not have taken up the offer and by so doing was committing herself to receiving inadequate consideration and was thereby making a gift.

D. *Preference Shares with Rights Converting on Holder's Death*

In this section of the paper four cases will be examined, two from Australia and two from Canada. In each case the deceased person was the holder of shares in a company whose shares were greatly more valuable while the deceased was

48 Ibid., 3.
49 *Minister of Finance* v. *Mann Estate* [1973] C.T.C. 561; *M.N.R.* v. *Estate of Smith* [1975] C.T.C. 335; *Estate of A. W. Beament* v. *M.N.R.* [1970] C.T.C. 193.

alive as the death of the deceased reduced that value. The Commissioner in Australia and the Minister of National Revenue in Canada sought to assess the respective deceaseds' estates on the basis of the greater value of the shares.

In *Estate of A. W. Beament* v. *Minister of National Revenue*[50] the deceased incorporated an investment holding company. The shares in this company were divided into Class A shares and Class B shares and the rights attaching to the two classes of shares varied. Both the Class A shares and the Class B shares were entitled to a 5% cumulative preferential dividend and that dividend having been paid, the Class B shareholders were entitled to the remaining net earnings of the company arising from income but not from capital gains. However, on a winding up the Class B shares were limited to receiving the par value of their shares ($1.00) and no more, while the Class A shares were entitled to the balance of the company assets. Each share carried one vote.

At the time of his death the deceased held 2,000 Class B shares while two of his children held 12 Class A shares each. When subscribing for their shares the children of the deceased entered into an agreement with the deceased in which the deceased covenanted to insert a direction in his will to direct his executors to wind the company up.[51] The deceased's will contained such a direction. In the deceased's estate tax return the value of the Class B shares was disclosed at par together with an additional sum for dividends accrued to death.

The sole question before the court was whether the value of the deceased's shares should be considered subject to the effects of the agreement and subsequent will or free from the obligations arising from that contract. Chief Justice Cartwright said:[52]

> Once it is established (and it has been conceded) that the contract binding the deceased and his executors to have the company wound up was valid, the real value of the shares cannot be more than the amount which their holder would receive in the winding-up. To suggest that they have in fact any other value would be altogether unrealistic. When the true value of the shares in the circumstances which exist is readily ascertainable, I can find nothing in the Act that requires the computation of the value they would have had under completely different circumstances followed by an inquiry as to whether any deductions should be made from that value.

And further:[53] "It is plain . . . that no sensible person would have paid more than $10,725.98 and that on a winding-up the executors could not receive more than that amount."

Accordingly the shares were valued subject to the effects of the agreement and subsequent will and the Minister of National Revenue's assessment was rejected. However, the Chief Justice[54] suggested that the provisions of section 3(1)(d) and (e) of the Estate Tax S.C. 1958 might embrace the situation.[55] As this did not form part of the pleadings no opinion was expressed on the subject.

Argument on that section did arise in the subsequent decision of *Minister of National Revenue* v. *Estate of M. I. Smith*.[56] This case was heard before the Federal Court of Appeal and in the words of Urie J.:[57] "It should be noted

50 [1970] C.T.C. 193.
51 For the exact terms of the covenant, ibid., 195.
52 Ibid., 198.
53 Idem.
54 Ibid., 199.
55 See n. 59 and 60, infra.
56 [1975] C.T.C. 335.
57 Ibid., 339.

that the factual situation leading to the assessment attacked is almost identical with that in the case of *The Estate of Arthur Warwick Beament* v. *MNR*." The holding company, the shares in which were those subject to the disputed valuation, had the same capital structure as in *Beament* with a similar agreement and will direction. There was an additional clause entrenching the rights attaching to the Class A shares.[58] The Minister contended that the value of the shares was $100,000 on the basis that because of the deceased's retention of an interest in the income and principal of the assets sold to the company bona fide possession was not given to the company. Thus his assessment was based on section 3(1)(d) of the Estate Tax Act S.C. 1958.[59] The Minister further relied on the provisions of section 3(1)(e).[60]

Since all the transfers of property to the holding company were for full consideration the court considered that the bona fides of the transactions was such as to prevent the operation of the sections. Further, the structure of the article relating to variations of class rights precluded the issue of shares to the deceased or otherwise allowing her to alter the rights attaching to the shares and thus did not permit her to take any action in respect of the distribution of the assets of the company. Thus there was no interest retained by the deceased without adequate consideration and the Minister's arguments were rejected. The value of the deceased's shares for estate purposes was their par value — being their entitlement on a winding up. Thus while alive the deceased enjoyed the benefits of the ownership of her shares without adverse estate tax consequences.

The decision of the High Court of Australia in *Robertson* v. *Federal Commissioner of Taxation*,[61] disclosed a far-sighted estate plan which relied on the reduced value that attaches to preference shares with low dividend entitlements and relied on the effects of conversion of the rights attaching to ordinary shares on death.

The deceased died owning a large number of shares in a private company. In 1929 the articles of that company had been altered to provide that upon the death of the deceased the rights attaching to the shares in the company would alter. The effect of the alteration of rights was to make those shares *not* owned by the deceased (No. 1 class shares) more valuable than shares owned by the deceased (No. 2 class shares). This was achieved by attaching to the No. 1 class shares a 10% preferential dividend entitlement as opposed to a 5% entitlement attaching to the No. 2 class shares and which entitlement was effective only after the No. 1 class shares had received their dividend. This altered entitlement

58 The exact terms of this provision are set out in the agreed statement of facts before the court and reported, ibid., 336-337.

59 That section included in the estates of deceased persons —

property disposed of by the deceased under a disposition whenever made, of which actual and *bona fide* possession and enjoyment was not, at least three years prior to the death of the deceased,

(1) assumed by the person to whom the disposition was made or by a trustee or agent for that person, and

(2) thereafter retained to the entire exclusion of the deceased and to the entire exclusion of any benefit to him, whether by contract or otherwise.

60 Framed in similar terms to s. 12(1)(a) and (b) of the Estate and Gift Duties Act 1968.

61 (1952) 86 C.L.R. 463.

took effect "upon the death" of the deceased. In addition the No. 1 class shareholders had a preferential entitlement on a winding up. So long as the deceased was alive there were various restrictive clauses in the articles preventing the transfer of shares in the company without the consent of the deceased.

Section 16A(1)(a) of the Estate Duty Assessment Act 1914-1947 provided that if the Commissioner thought necessary, the articles of the company whose shares were being valued should be valued on the assumption that at the date of death the articles satisfied Stock Exchange requirements. This section has the same intent as section 22 of the Estate and Gift Duties Act 1968, that is to say to avoid a depressing effect on the value of shares by the use of articles restricting alienation.

The respondent Commissioner sought to argue that the changed rights attaching to the shares could be ignored by applying the section. If this argument were successful, it was agreed by the parties to the action that the shares would have a value much greater than if they were valued taking into account the low preferential entitlement. The facts of the action were submitted to the court by agreement and it was also agreed between the parties that if the Commissioner's argument about section 16A(1)(a) was unsuccessful then the shares would have the lower value. If the Commissioner was successful a higher agreed value would be placed on the shares.

The Commissioner also argued that section 8(4)(e) of the Estate Duty Assessment Act applied. This section stated[62] that the property of the deceased person would include property

> being a beneficial interest in property which the deceased person had at the time of his decease which beneficial interest by virtue of a settlement or agreement made by him passed or accrued on or after his decease to, or devolved on or after his decease upon any other person:

The three judges of the High Court rejected each of the Commissioner's contentions. Their reasons for doing so were delivered in three closely reasoned judgments.

Williams J.[63] when dealing with the arguments concerning section 16A(1)(a) first held that it was not necessary to apply this section because the altered articles applied upon the date of death. During the lifetime of the deceased, the existence of the disputed article would have prevented the company from complying with the requirements of the Stock Exchange. The altered articles however, met both requirements and thus on and from the death of the deceased there was no need for the Commissioner to resort to section 16A(1)(a) when seeking to value the shares.

Williams J. also said that the deceased was not in a position to make a settlement or agreement about the shares the subject of the altered articles because those shares were not his property to settle or agree about. Williams J. considered that for the purposes of section 8(4)(e) the beneficial interest in property the subject of the agreement had to be the interest in the shares. He did not consider that the articles of the company were an agreement sufficient to justify the

62 The nearest equivalent in the Estate and Gift Duties Act 1968 is s. 15.
63 Supra n. 61 at 472-480.

operation of section 8(4)(e). The articles he said, merely altered contractual rights and did not cause any beneficial interest in any property owned by one person to accrue to any other persons.

Taylor J. first held that section 8(1) contemplates a valuation of shares being made as at the death of the deceased and not at any other time. Thus he said[64]

> . . . if the articles of association of a company, in which a deceased person held shares, satisfy the relevant stock exchange requirements *at the death* of such person, then in the words of the section they satisfy such requirements 'at the date of death'.

The evidence before the court was that the existence of the relevant article (article 6) no longer precluded the company from Stock Exchange listing. The plain words of the article were that it was to operate "upon the death of [the deceased]".

Considering the impact of section 8(4)(e) Taylor J. suggested[65] that the Commissioner was obliged to concede that the exclusion of article 6 by applying section 16A(1)(a) was not legally permissible.

> Whilst conceding that the effect of the article at the time of the deceased's death might well have been to increase the value of the shares held by the other shareholders, I would find difficulty in holding that a 'settlement' or 'agreement' within the meaning of the Act could be implied from the circumstances mentioned, and even greater difficulty in holding that the increase in value to which I have referred should in any way be regarded as property or an interest in property or as a 'beneficial' interest in property.

Kitto J. did not discuss the arguments about section 8(4)(e). He was content to agree with the reasoning of his brother judges. Kitto J. did however, go to some length in discussing the arguments about section 16A(1)(a). His judgment sets out many of the arguments concerning the expression "at the date of death". He said[66]

> The intention of the section cannot be that the critical time as at which the necessity for notionally altering the articles must be decided shall be a point of time other than that as at which the valuation has to be made.

At page 485 Kitto J. quoted Palles C.B. from the decision *In Re Augusta Magan:*[67] " . . . the passing of the property was the effect of the death . . . and in nature the event must precede the effect which is to ensue upon it". Kitto J. agreed with this statement and having done so did not think the Commissioner should succeed for the reasons enunciated in *Magan:*[68]

> It is not until there is an estate of a deceased person that the Act speaks. It follows that in the present case the estate must be valued as at the death, but on the hypothesis that the deceased has died. In valuing the shares on that hypothesis there cannot be a necessity to apply s. 16A(1)(a) in order notionally to alter the articles in relation to article 6, for it is involved in the hypothesis itself that article 6 no longer

64 Ibid., 491.

65 Ibid., 493.

66 Ibid., 483. The difficulties associated with "death" are also analysed by Kite in this volume and in the case of *Re Alex Russell* infra n. 69.

67 [1922] 2 I.R. 208, 210.

68 Supra n. 61 at 486-7.

presents any obstacle to listing. At no time while article 6 prevented listing did the Act require the shares to be valued. It was only when they had acquired the character of a deceased person's estate that it became necessary to value them.

The aim of this estate planning exercise carried out in 1929 was to enable the deceased to control his company while alive and receive the fruits of that company's profitability. However, at the same time the value of the shares which enabled him to do that was not a major estate asset attracting estate duty.

In *Re Alex Russell*[69] an optional right of conversion of preference shares to ordinary shares that was personal to the holder received judicial consideration. In this case, as noted earlier, the deceased during his lifetime sold land to a company which at the time of sale of the land had only five shares. The land was paid for by the company by allotting to Russell 20,000 preference shares worth £1 each, the shares being issued at a premium of £4 per share. There was a preferential dividend entitlement of eight per cent and on a winding up the preferential shareholders were entitled to the par value of their shares only. Russell was however, given power during his lifetime at any time to convert his preference shares into ordinary shares. He died without ever exercising this option. The Commissioner contended that the right possessed by Russell was a power of appointment and sought to value the preference shares owned by Russell as if they were ordinary shares worth a great deal more than shown by the executors in their return.

It was held that the right of conversion which the deceased had during his lifetime was not property of which the deceased at the time of his death was competent to dispose because the power ceased at death. This conclusion was reached after a lengthy and fully reasoned judgment, during the course of which McInerney J. said:[70]

> It is clear that up to the very moment of his death the testator retained and could have exercised the power conferred on him . . . to convert all or any of his preference shares into ordinary shares . . . It could not, however, be exercised by will. The testator not having exercised that power during his lifetime, it ceased, upon his death, to exist or to be exercisable.

It was further held that since the consideration sought for the shares was adequate there was no inter vivos gift.

In coming to his conclusion McInerney J. made several comments concerning the rights attaching to shares. He held that the rights attaching to the preference shares in *Russell* could not be separated from the preference shares themselves and he observed[71]

> It follows that while it is correct to speak of the testator's preference shares as consisting of a bundle or congeries of rights, it is not correct to speak of the shareholder owning each of those rights as a separate piece of property, or as a separate chose in action. The true position is, as Williams J. observed in *Archibald Howie Pty Ltd* v. *Commissioner of Stamp Duties*[72] that those rights 'are ingredients in the chose in action which each original shareholder purchased from the Company'.
> It is not permissible, therefore, to separate out the various rights appertaining to the holder of preference shares . . . 'The property in shares is the property that exists

69 [1968] V.R. 285.
70 Ibid., 301.
71 Ibid., 299-300.
72 (1948) 77 C.L.R. 143, 157.

in the shares themselves' per Williams J., in *Robertson* v. *F.C.T.*[73] at p. 480. . . . It does not follow that those ordinary share rights or that 'chose in action', or that 'other interest' in personal property, had a separate existence from the preference share in which they inhered. In my view, they had no such separate existence and did not constitute separate 'property' forming part of the notional estate of the testator. On the contrary, whatever rights were, at the death of the testator 'locked up' in the preference shares owned by him were part of those shares, and those shares formed part of his actual estate. There could not, at the same time, be separated out of the actual estate constituted by those shares, certain rights (of conversion of those shares into ordinary shares) so as to become dutiable separately as part of his notional estate.

These comments assume some significance later in this paper.

III. IMPLICATIONS FOR THE NEW ZEALAND ESTATE PLANNER

Beament and *Smith* are excellent examples of what every estate planner should aim to achieve. The deceased while alive was entitled to the receipt of income, actually owned shares but those shares were greatly reduced in value on death. The armoury of the Minister of National Revenue was proved to lack a weapon with which to attack the scheme. Salient features of the scheme were that all assets held by the holding company (in which the deceased held shares) were transferred to the company for full consideration,[74] and the shares allotted to the children were also allotted for full consideration. The suspect areas of the scheme were the price paid by the deceased and the children for their shares (not in issue in either *Beament* or *Smith*) and the effect and nature of the collateral agreement to wind up. If the deceased had paid excessive consideration when subscribing for her shares there may have been said to have been a gift.[75] There would be difficulties in calculating the appropriate consideration payable by the children for the shares since if death was a likely occurrence the shares would possess an expectant higher value to recognize their increased worth after death. Further while the agreement enabled the value of the children's shares to be realized no property passed under it and it did not of itself constitute a gift.

It is submitted that a *Beament* scheme would have the same result if it took place in New Zealand. The sections of the Estate and Gift Duties Act 1968 that would be relevant in any assessment by the Commissioner would be sections 18, 11 and 12. The approach adopted by Cartwright C.J. in *Beament* regarding the value of the shares at the date of death of the deceased would be followed in New Zealand for in the face of an enforceable contract to have the company wound up no willing purchaser of its shares would pay more than their value on a winding up.[76] Indeed if a greater value was paid he could arguably be accused of making a gift to the vendors of the shares.

Section 11 would have no application because for that section to apply there

73 (1952) 86 C.L.R. 463.
74 In *Smith,* for example, the deceased received promissory notes for the purchase price.
75 Cf. *Grant* v. *F.C.T.* supra n. 10.
76 It should be noted that in the New Zealand context s. 22 could not apply because the agreement was not embodied in the articles or memorandum. Section 24, which does cover agreements, only applies to partnerships.

must first be a gift. Given transfers for full consideration then there is no gift. Further even if there is a gift[77] then bona fide possession of the property transferred to the company would be enjoyed by the company and the donor would be precluded from any further benefit in the property other than her separate contractual right as a shareholder in the holding company. The donor's rights as shareholder in the company would be separate from the interest in the property gifted.[78]

Section 12 would probably have no application because following the disposition of the disponor's property to the company there would be no reservation of an interest in that property as it could be dealt with by the company as it chose. There would be no reservation of a benefit accompanying the disposition nor would the disponor have any power to reclaim the property. The effect of the transaction would be that the company would have assumed entire beneficial and actual ownership of the property in question. The entrenchment of rights attaching to the share in the company would preclude the deceased from having the ability to alter the winding up entitlement of her shares and winding up the company thereafter.

The decision in *Robertson* raises several queries in the New Zealand context. First, in order to justify an assessment at the increased value in a *Robertson* scheme, the Commissioner could argue that "at the moment of death" for the purposes of section 18, the shares in a *Robertson* scheme had the value before the relevant articles effected the change in values. That is to say, at the date of death the shares were worth the higher amount as the articles could not operate until after death. This would necessarily involve a New Zealand court not following the judgments of the three members of the High Court in *Robertson.*

Section 18 states that property of the deceased shall be valued as at the date of death of the deceased. What the Commissioner must argue is that "at the date of death" is a wide term that is not to be defined with precision, or alternatively, argue that date means value on the day in question. But if the articles giving rise to the share rights alterations are phrased in the same way as the section, then the Commissioner or court, as the case may be, would be forced to define precisely the moment of valuation. The approach taken by all the judges in *Robertson* varied but the conclusion of the court, and indeed the ratio of the decision, was that the Commissioner was obliged to consider the effect of the relevant article before arriving at some value for the shares. It is submitted that this decision (especially the judgment of Kitto J.) is highly persuasive and would be followed in New Zealand.[79]

Secondly, it is submitted that it would not be open to the Commissioner to argue that the change in share values by means of altering the rights attaching to those shares brought about in a *Robertson* scheme is within the ambit of section 7 of the Estate and Gift Duties Act 1968 which provides: "The dutiable estate

77 For example a Deed of Release of Indebtedness to the company as part of a gifting programme.

78 See *St Aubyn* v. *Attorney-General* (No. 2) [1952] A.C. 15.

79 See *Re Silk* (1976) 6 A.T.R. 321; Kite, op. cit.; Green "Blood and Bone" [1977] N.Z.L.J. 220; *C.S.D. (N.S.W.)* v. *Bone* (1976) 6 A.T.R. 66.

shall include all property of the deceased which passes under his will or intestacy, except property held by him as trustee for another person".

This submission is based on two lines of argument. First, it is suggested that the change in share values brought about by the relevant article was not property passing. This was the argument that occupied Williams and Taylor JJ. in *Robertson* when considering section 8(4)(e) of the Estate Duty Assessment Act. The deceased's estate still retained shares (albeit worth less) and no other person acquired any title in those shares.[80] Secondly, and more importantly, the exchange in share values was the consequence of death and its effect on the company articles and even if it is conceded that this exchange in values was property passing[81] it was not property passing by will or intestacy. The property (if any) passed by virtue of internal company rules.[82] Consequently if the Commissioner is forced to rely on section 7 to bring the property to charge and the broader definition of 'disposition of property' (section 2(2)) does not apply, a transfer of value occasioned by documents, settlements or otherwise outside the will, will not be caught.[83] The extended meaning given to what is embraced by a 'disposition of property', as applied in *Ord Forrest,* would not be of assistance.

Thirdly, the Commissioner could resort to the provisions of the Act relating to gifts and notional estates. Section 10 provides: "The dutiable estate shall include any property comprised in any dutiable gift made by the deceased within three years before his death, whether before or after the commencement of this Act". A gift is a disposition of property for inadequate consideration[84] and section 2(2)(f) provides that a "disposition of property" includes —

> Any transaction or series of related or connected transactions entered into by any person with intent thereby to diminish, directly, or indirectly, the value of his own estate and to increase the value of the estate of any other person; . . .

The latter part of section 2(2)(f) provides that the passing of resolutions by a company altering the rights attaching to shares so that some shareholder's estates are increased at the expense of other shareholders is a transaction.

The impact of these two sections requires consideration as to their gift duty effect and estate duty effect. If the Commissioner is of the opinion that the passing of the resolutions necessary to change the articles is a transaction then he is entitled to consider that the person whose estate is thereby diminished (and who could have prevented the passing of the resolution) has made a gift. But as the value of gift must be determined at the time of the transaction (section 66) what is its value in a *Robertson* scheme?

Furthermore, if the person dies within three years of the passing of the resolution and it is considered a gift has thereby been made what 'property' is included in the deceased's notional estate for the purposes of section 10; and again, what was its value at the date of the gift (section 18)?

80 See infra.
81 Cf. *Overton's Trustees* v. *C.I.R.* [1968] N.Z.L.R. 872, and *Tatham* v. *C.I.R.* (1974) 3 A.T.R. 597.
82 See *Adams and Richardson's Law of Estate and Gift Duties* (5th ed., Wellington, 1978) 75-78 and 156.
83 See Green, op. cit., 227.
84 See s. 65, Estate and Gift Duties Act 1968.

The leading New Zealand authority on section 2(2)(f) is ***Robertson*** v. ***Commissioner of Inland Revenue***,[85] a case where a company by special resolution increased its share capital and allotted the newly created shares to trustees. The effect of the scheme was to halve the value of shares held by existing shareholders. It was held that this scheme amounted to a transaction within section 2(2)(f).

It could probably be successfully argued that the alteration to the articles in a ***Robertson*** scheme amounts to a transaction entered into with the requisite intent on the authority of ***Robertson*** (N.Z.) and ***Gorton***. However there are complications as to when to determine the value of the gift. In ***Robertson*** (N.Z.) the issue was different in that the shares were immediately worth less. In ***Robertson*** (Aus.) the shares did not alter in value until after the death of the deceased when by definition no gift could be made. Thus there are clearly difficulties in making an assessment of gift duty. So long as the deceased was alive there would be no shift in values to a shareholder holding shares in the company. The shares would rank pari passu but be subject to the restrictive conditions of alienation as were present in ***Robertson*** and which would of course be ignored for the purposes of section 22.

The problem of assessment is further compounded in that a gift is a disposition ot property for inadequate consideration. At the time the Article is passed but while the deceased is alive, what consideration should be payable by the other shareholders who may stand to gain from the alteration to the Articles? The gain that may accrue to the shareholders is entirely an expectant gain, expectant upon their surviving the person mentioned in the relevant Article. If that person was young and in good health then the increase in value to shares held by other persons could be a long time in arriving and the value of gift considerably reduced. On the other hand if the alteration took place when the person mentioned in the Article was facing imminent death from a terminal illness then and in such case the alteration of the Article if made by that person would be within section 2(2)(f) and assessable for gift duty to the extent of the inadequacy of the consideration paid to that person by the shareholder who stood to gain. As ***Goodman*** says in his article[86]

> This problem was avoided in ***Robertson***, where the shares which Robertson acquired from the company in 1929 must have had exactly the same fair market value as any other shares of the company up until the moment of his death in 1945. If he had sold them immediately before his death, the purchaser would have had these shares converted upon Robertson's death to Class No. 1 shares (the more valuable shares), even though they would have been converted into Class No. 2 shares if they had remained in Robertson's ownership at his death. The usual difficulty with an estate planning scheme which uses a class of shares which will be reduced in value on the client's death is that the client is usually older and in poor health at the time he embarks on the scheme, and there is, therefore, a substantial element of gift involved in his buying shares which are worth less than he pays for them, even at the moment of purchase. This difficulty was overcome in ***Robertson*** by ensuring that the reduction in value of Robertson's shares on his death was personal to him and that it did not affect their value in the hands of anyone to whom he transferred these shares during his lifetime.

85 [1959] N.Z.L.R. 492.

86 Supra n. 43, at 338-339.

The same considerations as to the value of the gift would apply whether the disposition of property was by virtue of section 2(2)(c) or (d).[87]

As illustrated above, for the purpose of gift duty, in a *Robertson* scheme the question of valuation of the gift will be difficult and will entirely depend on particular factual circumstances. Nevertheless persons contemplating such a scheme may consider that an agreement between the donor in such a scheme and the other shareholders (donees) would be desirable, such agreement to specify consideration for the expectant increase in value and subject to an escalation clause for re-assessment.

For the purpose of estate duty what property is included in the dutiable estate of the donor (since deceased), and does the concept of "property" — undefined in the Estate and Gift Duties Act 1968 — include the contractual rights of shareholders? The property that is to be included in the notional estate of the deceased must be the choses in action that accrued to the shareholders benefitting from the alteration, but these choses in action are the rights of the shareholders both inter se and against the company and were not property interests formerly owned by the deceased. McInerney J. in *Russell's* case[88] quite unequivocally stated that the rights attaching to shares cannot be separated from the shares themselves. If this is correct, and it is submitted that it is, then no property passed as a result of the transaction, the property at all times being retained by the deceased, the other shareholders of the company receiving no additional property but receiving the expectant increase in the value of that property.[89] This being so, there is no property that can be separated out of the gift and included pursuant to section 10.

It has been suggested elsewhere[90] that:

> It appears that if dispositions under para. (f) are not to escape gift duty, and the notional estate provisions, the Courts will have to give a liberal interpretation to the wording of the Act. A possible pragmatic approach, giving effect to the Act but with little support from the actual wording used, would be to regard the requirements of the Act as satisfied if the 'property comprised' in a disposition, although not represented by separate property which can be pointed to after the disposition, is represented merely by an increase in the value of the donee's estate.

This in essence suggests that the value of the gift is the property for the purposes of section 10. If this is what the legislature intends then clear words are necessary to support such an interpretation and those clear words are not present.[91]

Finally, the Commissioner could present an argument based on section 12. The argument would proceed on the basis that the transactions that had the effect of diminishing the value of the deceased's estate were accompanied by a reservation of an interest in the property given away, or are otherwise within section 12(1) (a), (b) and (c).

87 Arguments under s. 2(2)(c) and (d) would proceed on the basis that the release of rights attaching to shares and the creation of rights attaching to other shares were within the meaning of those sections.

88 [1968] V.R. 285.

89 See *D'Avigdor Goldsmid* v. *I.R.C.* [1953] A.C. 347, and cf. *Robertson* v. *C.I.R.* [1959] N.Z.L.R. 492.

90 Congreve "Gifts for Duty Purposes" in Richardson (ed.) op. cit. 11.

91 But see *Overton's Trustees* v. *C.I.R.* [1968] N.Z.L.R. 872, 882 where the concept of property was equated with a change in value.

The Commissioner must prove that there has been a 'disposition of property' by relying on the broader concept of a change in values as enunciated in *Overtons Trustees* v. *C.I.R.*[92]. If it is accepted that the property is the value transferred then that transfer of value is accompanied by the reservation of a benefit for the deceased for his life namely the full rights of ownership of the shares. There appears to be no room for an argument that the rights[93] attaching to the shares were retained and not reserved, for the concern is with benefits not property.

However it can be argued that the only "value" given away is the expectant increase in value of the other shareholders' shares and the corresponding expected decrease in value of the shares held by the subject of a *Robertson* scheme. He has no interest in this expectancy; it is of no use or benefit to him. The only benefit retained is ownership of the shares which rights of ownership he has never relinquished. It is submitted therefore that section 12 may not be applicable.

The issues involved in assessing the viability of a *Robertson* scheme in New Zealand are complex.[94] However, it is submitted that a *Robertson* scheme would succeed if attempted in New Zealand. It is pertinent to note that in Australia Victorian practitioners would have little hope in succeeding with such a scheme because of the legislation contained in the Victorian Probate Duty Act 1962. Section 8(1)(b) provisos (a) to (c) and section 8(2)(a) to (c) comprehensively deal with efforts to vary the value of shares on death such as found in *Robertson* itself or modifications of that scheme. It is suggested that for the New Zealand Commissioner's armoury to remain effective similar comprehensive legislation is required.

Because of the inherent risk of lengthy and expensive litigation that could follow upon the implementation of a *Robertson* scheme it may not be wise to use it as part of a day-before-death estate plan but instead as part of a longer term project involving a steady disbursement of shares in addition to the controversial article. The relevant article having been passed and the critical three year time period having elapsed, the normal methods of diminishing an estate could be implemented.

The *Russell* case, it is submitted, can also withstand an effort by the Commissioner to assess the convertible, but not converted, preference shares as ordinary shares for the purposes of calculating estate duty. The section of the Act upon which the Commissioner sought to rely in *Russell's* case is framed in similar terms to section 8 of the New Zealand Act and, as seen, the arguments put forward then by the Commissioner were rejected in a lengthy and thorough review of the authorities by McInerney J. In principle there appears to be no reason why they should not be rejected if the Commissioner put forward those arguments in a New Zealand Court.

In *Russell* the Commissioner was constrained in that he could not rely on a notional estate provision such as section 10 (gifts within three years) or section 11 (gifts with strings attached) of the New Zealand Act. The power to convert

92 Idem.

93 See French, *Reservations, retentions, and the property comprised in the disposition by the creation of a trust* in this volume.

94 Especially when compared with the relatively transparent scheme disclosed in *Robertson* v. *C.I.R.* [1959] N.Z.L.R. 492.

the preference shares to ordinary shares meant that the consideration paid for the shares was adequate and there was no dutiable gift. Thus while he was alive Russell reserved to himself the power to receive full consideration for his shares but because this right was purely personal it did not justify the Commissioner attaching an additional value to the shares after Russell's death.

IV. CONCLUSION

The aim of this paper has been to examine some methods by which preference shares can form part of an estate plan. For the purpose of this examination a review of reported cases involving such plans was undertaken. Their implications for the New Zealand estate planner were then discussed. The decisions revealed that the preference share has attributes that can have most desirable consequences for estate duty purposes. In particular it has been seen that the preference share can enable the holder to control a company without that element of control giving rise to valuable and dutiable shares in the holder's estate. This can be achieved either by emphasis on the control aspect of the preference share or by the more controversial schemes involving a conversion of the rights attaching to preference shares on death.

In New Zealand there is little authority on the use of the corporate entity as a tool of estate planning. It is hoped that the foregoing review provides some indication of possible planning opportunities that might be available.