Inland Revenue
Te Tari Taake

PUBLIC RULING BR PUB 20/06: Income Tax and Goods and Services tax – Director's liability and the COVID-19 "safe harbour" in schedule 12 to the Companies Act 1993

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

This Ruling applies in respect of s HD 15(1) of the Income Tax Act 2007 (ITA) and s 61 of the Goods and Services Tax Act 1985 (GSTA).

The Arrangement to which this Ruling applies

The Arrangement is the directors of a company, in good faith, agreeing to the company carrying on business, including trading and incurring obligations, in reliance on the COVID-19 "safe harbour" in schedule 12 to the Companies Act 1993 (CA) during the "safe harbour period".

The safe harbour period started on 3 April 2020 and ends on the close of 30 September 2020 (or later, if the period is extended by regulation).

During the safe harbour period, a decision by the directors of a company to keep on trading, as well as decisions to take on new obligations, will not result in a breach of the duties in ss 135 and 136 of the CA. Sections 135 and 136 of the CA provide that a director of a company must not:

- agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors;
- cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
- agree to the company incurring an obligation, unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

A company's directors can rely on the safe harbour only where:

- the directors consider in good faith that the company is facing or is likely to face significant liquidity problems in the next six months because of the impact of COVID-19 on the company or its creditors;
- the company was able to pay its debts as they fell due on 31 December 2019 (or the company was incorporated on or after 1 January 2020 but before 3 April 2020); and
- the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for example, because trading conditions are likely to improve or the company is likely to able to reach an accommodation with its creditors).

For the avoidance of doubt, this Arrangement does not include any particular "arrangement" entered into in relation to a company that, on its own terms, would ordinarily be subject to s HD 15 of the ITA or s 61 of the GSTA, even if it is entered into during the safe harbour period.

How the Taxation Laws apply to the Arrangement

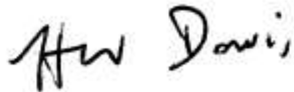
The Taxation Laws apply to the Arrangement as follows:

- Reliance on the safe harbour by a director, and the company continuing to trade or carry on business or incur new obligations on commercial, ordinary business terms, will not, in and of itself, result in the application of s HD 15 of the ITA or s 61 of the GSTA.
- For the avoidance of doubt, s HD 15 of the ITA or s 61 of the GSTA would still apply to any particular "arrangement" entered into in relation to a company that, on its own terms, would ordinarily be subject to those provisions, even if it is entered into during the safe harbour period.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning on 3 April 2020 and ending on 30 September 2020.

This Ruling is signed by me on 10 July 2020.



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COMMENTARY ON PUBLIC RULING BR PUB 20/06

This commentary is not a legally binding statement. This commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 20/06 (the Ruling).

Relevant legislative provisions are reproduced in the Appendix to this commentary.

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Summary

1. Under the recently enacted COVID-19 safe harbour in schedule 12 to the Companies Act 1993 (CA), during the safe harbour period certain decisions by the directors of a company, will not result in a breach of the duties in ss 135 and 136 of the CA where:
   - the directors consider in good faith that the company is facing or is likely to face significant liquidity problems in the next six months because of the impact of the COVID-19 pandemic on the company or its creditors;
   - the company was able to pay its debts as they fell due on 31 December 2019 (or the company was incorporated on or after 1 January 2020 but before 3 April 2020); and
   - the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for

example, because trading conditions are likely to improve or the company is likely to able to reach an accommodation with its creditors).

2. It is possible (if not likely) that despite the existence of the safe harbour, some companies will still face insolvency and be unable to pay their tax liabilities. This raises the issue of whether a director of a company who has made decisions in reliance of the safe harbour, or a relevant shareholder of the company, could be liable for the tax liability.

3. Section HD 15 of the Income Tax Act 2007 (ITA) (asset stripping of companies) permits income tax owing by a company to be recovered from the company's directors and shareholders where an arrangement has been entered into that has an effect that the company cannot meet a tax liability. Section 61 of the Goods and Services Tax Act 1985 (GSTA) provides that s HD 15 applies as if "income tax" and "tax" read "goods and services tax".

4. Section HD 15(1) of the ITA sets out when the section applies, with the liability for a director or shareholder (as agent) being provided for in s HD 15(3) to (5) and (7). This Ruling and commentary are limited to whether the requirements of s HD 15(1) of the ITA, and therefore s 61 of the GSTA, are met in the context of the safe harbour and do not provide guidance on the application of those sections more generally.

5. For s HD 15 of the ITA to apply, four requirements must be satisfied:
   - An arrangement is entered into in relation to a company.
   - The arrangement has an effect that the company cannot meet a tax liability (either an existing liability or one that arises later).
   - It is reasonable to conclude that a purpose of the arrangement is that the company cannot meet or will not be able meet a tax liability.
   - It is reasonable to conclude that if a director of the company at the time of the arrangement had made reasonable inquiries, they could have anticipated that the tax liability would, or would likely, be required to be met.

6. Determining the effect and intended purpose of an arrangement is highly fact specific.

7. Considering the four requirements, for s HD 15 of the ITA or s 61 of the GSTA to apply, it is necessary for the arrangement to:
   - involve the depletion of the assets of a company; and
   - be designed to have the effect that the company cannot pay a tax obligation.

8. The Commissioner's view is that s HD 15 of the ITA or s 61 of the GSTA will not apply to a company that is unable to pay a tax obligation where:
   - the directors of a company facing significant liquidity problems because of the effects of COVID-19 and the resulting economic climate, decide in good faith to rely on the safe harbour and continue carrying on business; or
   - as a result of the directors' decision to rely on the safe harbour, the company continues carrying on business and trading or incurs new obligations on ordinary commercial business terms (for example, bank loans or sales at credit).

9. However, s HD 15 of the ITA and s 61 of the GSTA will still, in the Commissioner's view, apply to any arrangement that would ordinarily be subject to the provision, notwithstanding that the arrangement was entered into during the safe harbour period following a company directors' decision to rely on the safe harbour.

10. Examples illustrating the general approach to the application of s HD 15 of the ITA and s 61 of the GSTA in the context of the COVID-19 safe harbour can be found later in this commentary.

Background – safe harbour

11. The COVID-19 Response (Further Management Measures) Legislation Bill Government Act 2020 introduced, among other things, a "safe harbour" in relation to two directors' duties in the CA. The Companies Office describes this safe harbour on its website:[1]

> The introduction of a 'safe harbour' from sections 135 and 136 of the Companies Act 1993 will provide relief to company directors facing insolvency as a result of COVID-19.
>
> The 'safe harbour' provisions – which have been backdated to April 3, when the proposals were first announced – aim to ease the pressure on directors who may otherwise feel the need to wind up their business, perhaps prematurely, owing to the current climate.

12. The relevant directors' duties in ss 135 and 136 of the CA provide as follows:

> **135 Reckless trading**
>
> A director of a company must not—
>
> (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.
>
> **136 Duty in relation to obligations**
>
> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

13. Directors will be able to rely on the safe harbour only if they are facing significant liquidity problems because of the impact of COVID-19. All other obligations and duties under the CA must still be complied with, including the duty to always act in the best interests of the company.

14. The safe harbour provisions are in schedule 12 to the CA and set out in full in the Appendix. The purpose of the safe harbour is described in cl 1 of schedule 12:

> **1 Purpose of schedule**
>
> (1) The purpose of this schedule is to give to directors of companies that are facing significant liquidity problems because of the effects of the outbreak of COVID-19 more certainty about their duties when—
>
> (a) agreeing to the business of the company being carried on or causing or allowing the business of the company to be carried on; and
>
> (b) agreeing to the company incurring obligations.
>
> (2) However, it is not a purpose of this schedule to facilitate the ability of a company that has no realistic prospect of continuing to trade or operate in the medium or long term to defer a decision to enter into liquidation to the detriment of its creditors.

[1] Companies Office, "'Safe harbour' for company directors" (web page, 2020, https://companies-register.companiesoffice.govt.nz/help-centre/company-directors/safe-harbour-for-company-directors/).

15. Under cl 5 of schedule 12 the safe harbour period starts on 3 April 2020 and ends on the close of 30 September 2020 (or later, if the period is extended by regulation). In general (subject to some exclusions), cl 4 provides that the safe harbour provisions will apply to only a company that:
    - as at 31 December 2019, was able to pay its debts as they became due in the normal course of business; or
    - was incorporated on or after 1 January 2020 but before 3 April 2020.

16. Clause 6 of schedule 12 sets out the safe harbour relating to reckless trading (s 135 of the CA). The clause applies when a director of a company during the safe harbour period:
    - agrees to the business of the company being carried on in any manner; or
    - causes or allows the business of the company to be carried on in any manner.

17. Clause 6(2) provides that the actions of a director will not breach s 135 of the CA if, at the time of taking the action, the director, in good faith, is of the opinion that:

    (a) the company has, or in the next six months is likely to have, significant liquidity problems;

    (b) the liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and

    (c) it is more likely than not that the company will be able to pay its due debts on and after 30 September 2021 (or a later date prescribed by regulation).

18. Clause 7 of schedule 12 relates to the duty in relation to obligations in s 136 of the CA and will apply to a director of a company who:
    - during the safe harbour period, agrees to the company incurring an obligation; and
    - at that time, is, in good faith, of the opinion that the company has, or in the next six months is likely to have, significant liquidity problems.

19. Clause 7(2) provides that for the purposes of s 136 of the CA, the director has reasonable grounds to believe the company will be able to perform the obligation when it is required to do so if the director, in good faith, is of the opinion that:

    (a) the liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and

    (b) it is more likely than not that the company will be able to pay its due debts on and after 30 September 2021 (or a later date prescribed by regulation).

20. In summary, the safe harbour provisions provide that directors' decisions to carry on business, and decisions to incur new obligations, from 3 April 2020 to the close of 30 September 2020 (unless extended by regulation), will not result in a breach of duties if:
    - the directors consider in good faith that the company is facing or is likely to face significant liquidity problems in the next six months because of the impact of COVID-19 on the company or its creditors;
    - the company was able to pay its debts as they fell due on 31 December 2019 (or the company was incorporated on or after 1 January 2020 but before 3 April 2020); and
    - the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for

example, because trading conditions are likely to improve or the company is likely to able to reach an accommodation with its creditors).

21. The safe harbour provisions are not designed to support an entity that has no realistic prospect of continuing to trade by deferring a decision about liquidation to the detriment of its creditors.

22. It is possible (if not likely) that despite the existence of the safe harbour, some companies will still face insolvency and be unable to pay their tax liabilities. This raises the issue of whether a director of a company who has made decisions in reliance of the safe harbour, or a relevant shareholder of the company, could be liable for the tax liability under s HD 15 of the ITA or s 61 of the GSTA.

23. It would be surprising for Parliament to have enacted the safe harbour to allow directors of companies adversely affected by COVID-19 to make certain decisions without breaching their duties under the CA, if relying on the safe harbour, without more, would be enough to result in liability under other legislation, such as s HD 15 of the ITA or s 61 of the GSTA.

Application of the legislation

Section HD 15

24. Section HD 15 of the ITA (asset stripping of companies) permits income tax owing by a company to be recovered from the company's directors and shareholders where an arrangement has been entered into that has an effect that the company cannot meet a tax liability. Section 61 of the GSTA is the corresponding provision in relation to GST. It provides that s HD 15 of the ITA applies as if "income tax" and "tax" read "goods and services tax". In the following analysis, references to s HD 15 should be read as also applying to s 61. Both provisions are set out in the Appendix.

25. Section HD 15(1) of the ITA sets out when the section applies:

> (1) This section applies when—
>
> (a) an arrangement has been entered into in relation to a company; and
>
> (b) an effect of the arrangement is that the company cannot meet a tax liability (the tax obligation) whether existing at the time of the arrangement or arising after that time, for—
>
> (i) income tax:
>
> (ii) a civil penalty, as defined in section 3(1) of the Tax Administration Act 1994:
>
> (iii) an amount payable under Part 7 of that Act; and
>
> (c) it is reasonable to conclude that—
>
> (i) a purpose of the arrangement is to have the effect described in paragraph (b); and
>
> (ii) if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the income tax liability would, or would likely, be required to be met.

26. For s HD 15 of the ITA to apply, four requirements must be satisfied:

- An arrangement is entered into in relation to a company (including a trustee company).

- The arrangement has an effect that the company cannot meet a tax liability (either an existing liability or one that arises later).
- It is reasonable to conclude that a purpose of the arrangement is that the company cannot meet or will not be able meet a tax liability.
- It is reasonable to conclude that if a director of the company at the time of the arrangement had made reasonable inquiries, they could have anticipated that the tax liability would, or would likely, be required to be met.

27. If these four requirements are met, the remaining subsections of the provision, set out when the directors and certain shareholders of the company can be treated as agents of the company in relation to the unpaid tax. Each of these requirements is discussed in turn below.

Arrangement has been entered into in relation to a company.

28. Section HD 15(1)(a) of the ITA requires an arrangement to have been entered into in relation to a company.

Meaning of an "arrangement"

29. An "arrangement" is defined in s YA 1 of the ITA:

> **arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect

30. The definition of arrangement provides for varying degrees of formality and enforceability. For example, an arrangement may be:
    - a legally binding contract;
    - an agreement or plan that may or may not be legally binding;
    - an understanding that may or may not be legally binding; or
    - a contract that is not enforceable at law due to public policy, contractual incapacity or illegality.

31. The courts have considered the predecessor definitions of arrangement to that in s YA 1 of the ITA, particularly in the context of the general anti-avoidance provision. They described an arrangement as embracing all kinds of concerted action by which persons may arrange their affairs for a particular purpose or to produce a particular effect (see, for example, the decision of Richardson P in the Court of Appeal in *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450)

32. An arrangement may involve more than one transaction or document. Whether two or more transactions or documents together constitute an arrangement is a matter of fact (*Peterson v CIR* [2005] UKPC 5 at [33]).

33. In determining whether transactions or documents (or both) are part of an arrangement, the courts generally ask whether:
    - the transactions or documents are:
        - sufficiently interrelated or interdependent (or both);
        - part of an overall plan to obtain a particular objective or outcome; or
    - there is prior planned linking or sequencing (or both) of the documents or transactions.

34. However, a mere sequence of events without overall planning is not sufficient to constitute an arrangement. In *AMP Life Ltd v CIR* (2000) 19 NZTC 15,940 (HC), McGechan J stated:

> [125] The four steps do not amount to a "contract, agreement, plan, or understanding". They are a **mere sequence of events, each with knock-on causative consequences**, but that situation does not suffice. The concepts of contract, agreement, plan or understanding **predicate some prior planned linking or sequencing** or both, and that element is absent.
>
> [126] … This is a sequence of events. It is the way things eventuated. It cannot be strained to fit within concepts involving overall planning such as contracts, agreements, plans or understanding. **The legislation is not aimed at simple sequences of events of this character without prior overall planning.** These happen, and are allowed for on the basis of experience, within the tax base. The legislation is concerned with planned measures, not allowed for, which degrade the tax base. [Emphasis added]

35. Therefore, an arrangement requires an overall plan or some prior planned linking or sequencing (or both) of transactions or documents.

36. Other aspects of an arrangement include the following:
    - An arrangement is defined to include a "plan", which could involve a single person (*Russell v CIR (No 2)* (2010) 24 NZTC 24,463 (HC) (footnote 33 at [101]) and *Russell v CIR* [2012] NZCA 128 (at [54]).
    - An arrangement does not require a consensus or a meeting of minds of two or more people, so a taxpayer could be party to an "arrangement" even if they are not consciously involved in or aware of the details (*Peterson* at [34]).
    - An arrangement may consist of more than one agreement, contract, plan or understanding, so an agreement, contract, plan or understanding may be part of a wider arrangement as well as being part of a separate narrower arrangement.
    - An arrangement includes steps and transactions that are entered into or carried out outside New Zealand (*BNZ Investments Ltd v CIR* (2000) 19 NZTC 15,732 (HC) at [123]).

37. When analysing the potential application of s HD 15 of the ITA in relation to the safe harbour, it is useful to keep in mind three potential arrangements:
    - The directors of a company facing significant liquidity problems because of the impact of COVID-19, decide, in good faith, to rely on the safe harbour and continue operating. Of itself, this may not be an "arrangement" – it may simply be a decision made by the directors. However, it could be a "plan", which is included in the definition of "arrangement" in s YA 1 of the ITA.
    - As a result of the directors' decision, the company continues to trade or takes on new obligations (for example, bank loans or sales at credit). A company simply engaging in trade is likely to be a mere sequence of events, so may be insufficient to be an "arrangement". However, any individual transaction or obligation entered into could be an "arrangement" in its own right.
    - During the safe harbour period, the directors resolve or arrange for the company to enter into an "arrangement" of a type that (of itself) would potentially be subject to s HD 15 of the ITA or s 61 of the GSTA absent the directors' decision to rely on the safe harbour.

Meaning of "in relation to"

38. Section HD 15(1)(a) of the ITA requires that an arrangement is entered into "in relation to a company".

39. On the face of it, the words "in relation to" appear to have a broad application. In *Shell New Zealand Ltd v CIR* (1994) 16 NZTC 11,303, the Court of Appeal considered that the words "in respect of or in relation to" were of the widest import. Similarly, *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239 (FCA) concerned a similar phrase, "in connection with". The court in *Claremont* considered that the phrase referred to a relationship between two things, but not necessarily a causal relationship. A similar view was also expressed in *Strachan v Marriott* [1995] 3 NZLR 272 (CA), where the court stated that the meaning of phrases such as "in connection with", "in relation to" and "in respect of" depend on the context in which the phrases are used. Hardie Boys J said (at 279):

> "In connection with" may signify no more than a relationship between one thing and another. The expression does not necessarily require that it be a causal relationship: *Our Town FM Pty Ltd v Australian Broadcasting Tribunal* (1987) 16 FCR 465, 479 per Wilcox J. But, as Davies J warned in *Hatfield v Health Insurance Commission* (1987) 15 FCR 487, at p 491:
>
> > "Expressions such as 'relating to', 'in relation to', 'in connection with' and 'in respect of' are commonly found in legislation but invariably raise problems of statutory interpretation. They are terms which fluctuate in operation from statute to statute. ... The terms may have a very wide operation but they do not usually carry the widest possible ambit, for they are subject to the context in which they are used, to the words with which they are associated, and to the object or purpose of the statutory provision in which they appear."

40. The phrase "in relation to" indicates that the arrangement must relate to the company itself. It would not be sufficient if the arrangement simply involves a company that is a party to an arrangement. This interpretation is supported by the language used in other parts of s HD 15 of the ITA; that is, regarding the effect of the arrangement on the company's ability to satisfy its tax liabilities.

Nature of the arrangement for s HD 15(1)(a) of the ITA

41. It is well established in case law that the arrangement for the purposes of s HD 15 of the ITA (or its earlier equivalents, s HK 11 of the Income Tax Act 1994 and s HK 11 of the Income Tax Act 2004) must involve the stripping or depletion of assets from the company. While the wording of the earlier provisions differs, the purpose and intended scope is the same as for s HD 15. For completeness, it is noted that the case law is unclear whether this is a requirement that is drawn from the language of subs (1)(a) or (b), but for current purposes it is not necessary to consider that distinction in any detail.

42. The High Court in *Spencer v CIR* (2004) 21 NZTC 18,818 considered the application of s HK 11 of the Income Tax Act 1994. In relation to the purpose of the section, Paterson J stated:

> [34] The general purpose of s HK 11 [now s HD 15] of the Income Tax Act is to enable the Commissioner to recover tax or, in this case, GST from the directors and shareholders of a company that has **entered into an arrangement or transaction to deplete the company's assets** so that it is unable to fully meet its tax liabilities. [Emphasis added]

43. Similarly, in *Case X11* (2005) 22 NZTC 12,175, Judge Willy stated:

> [9] It is clear from subs. (1) that the intention of the legislature is to allow the Commission to recover tax from the directors and shareholders of a company which has **entered into an arrangement an effect or purpose of which is to deplete or strip the company's assets** so that it is unable to meet it's tax liabilities. [Emphasis added]

44. Further, in *Henderson v CIR* [2016] NZHC 1987, (2016) 27 NZTC 22,068 (HC), Gendall J referred to the stripping of assets (specifically in relation to s HD 15(1)(b) of the ITA), stating:

> *Second requirement – was it an effect of the arrangement that each company cannot meet a tax liability?*
>
> [61] Under s 61 of the GST Act an effect of the arrangement must be that the company in question cannot meet a tax liability (either an existing liability or one that arises later).
>
> [62] In this case the sale to the Council of the properties concerned converted the assets of the companies from land and buildings to cash. **There can be no doubt that the net sale proceeds were then stripped from the companies** under the arrangement and following the various transactions and steps that were taken, the companies were unable to satisfy their GST debts. I am left in no doubt that this was the end result of the arrangement. It is what the arrangement achieved irrespective of any motive otherwise which the appellant maintains he had. It was the effect of the arrangement and it must follow therefore that the TRA [Taxation Review Authority] was correct to find that the second requirement under s 61 is satisfied.
>
> …
>
> [65] I am satisfied that **if any purpose of the arrangement was to have the effect of stripping assets from the company**, so that they were unable to satisfy their liabilities to creditors (of which their tax liability is one), then that is a sufficient purpose for this requirement to be met. It is not necessary that the purpose is the dominant or principal purpose. [Emphasis added]

45. The requirement that the "arrangement" involve the depletion or stripping of assets is also consistent with contextual and extrinsic material. The section heading of s HD 15 of the ITA is "asset stripping of companies", which is an indication from Parliament regarding the focus of the provision.

46. The business tax policy document released with the 1991 Budget (*Taxation Policy – Business Tax Policy 1991* (Ministers of Finance and Revenue, 30 July 1991)) referred to the need for the arrangement to involve the depletion or stripping of assets:

> ***Chapter 10: Tax Recovery***
>
> *Introduction*
>
> This chapter provides more information on the Government's decision to replace section 276 of the Income Tax Act with a better targeted tax recovery provision. **That new provision [what is now s HD 15] will enable the Commissioner to recover tax from the directors and shareholders of a company that has entered into an arrangement or transaction to deplete the company's assets so that it is unable to fully meet its tax liabilities.**
>
> ...
>
> **The new recovery provision will be triggered by arrangements or transactions that have been entered into to deplete the company of its assets so that it has insufficient funds to fully meet its tax liabilities.** However, it will not be triggered by formal arrangements (under insolvency proceedings) or informal arrangements (under section 414A of the Income Tax Act) between the Commissioner of Inland Revenue, the company and its other creditors, which result in the Commissioner accepting less than the full amount of tax outstanding. [Emphasis added]

47. Similarly, *Tax Compliance* (Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance, December 1998) states:

> 11.45 Section HK 11 is directed at arrangements **which deplete a company's assets** so that it is unable to meet its tax liabilities. The company is often liquidated as part of the arrangement, or simply because after a transaction is completed, the company serves no useful purpose. … [Emphasis added]

48. Finally, the Commissioner has taken a similar approach, in "Tax recovery provision: Application to civil penalties and interest" (*Tax Information Bulletin* Vol 17, No 7 (September 2005): 44) stating:

> Section HK 11 of the Income Tax Act 2004 is directed at arrangements which **deplete a company's assets** so that it is unable to meet its tax liabilities. [Emphasis added]

49. This material strongly suggests that a company's directors simply making a decision, in good faith, for the company to continue to carry on business, or to enter into an obligation due to the existence of the safe harbour will not be sufficient for s HD 15 of the ITA to apply. Similarly, a company carrying on trading or entering into obligations at a time when the directors believe, in good faith, that the requirements of the safe harbour are met will not fall within the scope of s HD 15. For s HD 15 to apply, it is necessary for the arrangement in question to involve the assets of the company being stripped or depleted.

Effect of the arrangement is that the company cannot meet a tax liability

50. The second requirement is that an effect of the arrangement must be that the company cannot meet a tax liability (s HD 15(1)(b) of the ITA).

Meaning of "effect"

51. The term "effect" has been discussed in the context of anti-avoidance provisions. In *Auckland Harbour Board v CIR* (1999) 19 NZTC 15,433 (CA), delivering the majority judgment of the Court of Appeal, Richardson P said (at 15,451) that "effect" meant the end accomplished or achieved:

> In context, we consider it [the word "effect"] has its standard meaning of "the end accomplished or achieved" (*Newton v C of T* (1958) AC 450 at p465).

52. Similarly, in his dissenting judgment in *CIR v BNZ Investments Ltd* (2001) 20 NZTC 17,103 (CA), Thomas J said (at 17,132) that the word "effect" directed focus to the result or consequence of an arrangement:

> **The word "effect" directs the focus to the result or consequence of the arrangement as opposed to a bare description of tax avoidance. It focuses on the physical characteristics of the arrangement.** (See The Valabh Committee, Key Reforms to the Scheme of Tax Legislation, Discussion Paper, October 1991, paras 3.5, and 3.6). The Courts have also held that the purpose of an arrangement is to be determined by its effect. It is sufficient to refer to the succinct statement of Woodhouse P in the *Challenge Corporation* case (at p 533): "I am satisfied as well that the issue... is something to be decided, not subjectively in terms of motive, but objectively by reference to the arrangement itself." [Emphasis added]

53. The approach taken by Thomas J was later endorsed by the Privy Council in *Peterson* at 34. Thomas J also said that the word "effect" focused on the physical characteristics of the arrangement.

54. In *Newton v FCT* [1958] 2 All ER 759 (PC), Lord Denning said (at 764) that you must look at the arrangement itself to see its effect—what it does—irrespective of the motives of the persons who made the arrangement:

> … In applying the section you must, by the very words of it, **look at the arrangement itself and see which is its effect – which it does – irrespective of the motives of the person who made it.** Mr Justice Williams put it well when he said:
>
> > "The purpose of a contract, agreement, or arrangement must be what it is intended to effect and that intention must be ascertained from its terms. Those terms may be oral or written or may have to be inferred from the

> circumstances but, when they have been ascertained, their purpose must be what they effect." [Emphasis added]

55. In summary, an effect of an arrangement is a result or consequence of the arrangement (in other words – what the arrangement does). Determining an effect of an arrangement is an objective test having regard to the outcome or outcomes of the arrangement itself. The motives of the parties are irrelevant. This determination is highly fact specific.

56. The word "effect" should be interpreted similarly in s HD 15 of the ITA. Determining an effect of an arrangement is an objective test having regard to the outcome or outcomes of the arrangement rather than the motives of the parties.

57. Section HD 15(1)(b) of the ITA refers to **an** effect of the arrangement. The use of the indefinite article "an" with the noun "effect" implies that the required effect may be one of multiple effects of the arrangement, irrespective of its prominence or its incidental nature. It need not be the sole, dominant, or principal effect. This means any arrangement that results in a company being unable to meet its tax obligations will have the requisite effect.

Meaning of "tax liability"

58. Section HD 15(1)(b) of the ITA requires that an effect of the arrangement is that the company cannot meet a tax liability.

59. The term "tax liability" is not defined in the ITA, GSTA or Tax Administration Act 1994. However, a tax liability is a key concept explained in the core provisions of the ITA. Under s BC 6 of the ITA the income tax liability for a filing taxpayer is the amount calculated by "multiplying their taxable income for the tax year by the basic rate of tax" (this is modified for scheduler income under s BC 7 of the ITA).

60. Section HD 15(1)(b) of the ITA defines the concept of a "tax obligation" as being a tax liability of the company that cannot be met as a result of the arrangement. That tax obligation can exist at the time of the arrangement or arise after the arrangement has been entered into. The tax liability must be for income tax (or GST by virtue of s 61 of the GSTA), a civil penalty, or interest.

Meaning of "cannot meet"

61. Based on the definitions of "can", "cannot" and "not" in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011), the ordinary meaning of "cannot" is not able to do something. The relevant meaning of the word "meet", according to that same dictionary, is to "fulfil or satisfy" a requirement or condition. Accordingly, under s HD 15 of the ITA an effect of the arrangement must be that the company is unable to fulfil or satisfy a tax liability.

62. This is consistent with the wording used in earlier equivalents of s HD 15, with s HK 11 of the Income Tax Act 1994 and s HK 11 of the Income Tax Act 2004 using the words "unable to satisfy".

63. Arguably, any arrangement that results in a company not being able to pay its tax will satisfy the requirement of s HD 15(1)(b) of the ITA. However, of itself this is not enough to conclude that the section will apply.

Whether it is reasonable to conclude that a purpose of the arrangement is that the company cannot meet a tax liability

64. The third requirement is that it is reasonable to conclude that a purpose of the arrangement is to have the effect that the company cannot meet a tax liability (s HD 15(1)(c)(i) of the ITA). The focus is on the purpose of the arrangement not the motive of any person.

65. Whether something is reasonable involves an objective test (see *Vinyl Processors (New Zealand) Ltd v Cant* [1991] 2 NZLR 416 (HC) at 420 and 421). What is reasonable may vary depending on the factual situation.

66. The way in which a purpose test is to be applied and the factors relevant in ascertaining purpose depend on the statutory context (*CIR v Haenga* (1985) 7 NZTC 5,198 (CA)).

67. The meaning of the purpose of an arrangement has been considered in the context of the general anti-avoidance provision s BG 1 of the ITA and earlier equivalent provisions.

68. In an avoidance context, the courts have held that the "purpose or effect" of an arrangement is determined objectively and the motives or intentions of the parties are not relevant. In that context, the courts have held that the purpose of an arrangement is the effect that is sought to be achieved or its intended effect.

69. This is evident from the decision of the Supreme Court in *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, [2009] 2 NZLR 359:

> [35] ... Secondly, the Commissioner must have been properly satisfied that the arrangement was entered into between the parties to it to defeat the intent and application of the Act or any provision of the Act. **This does not mean that the Commissioner must have been satisfied that the parties subjectively had that defeating purposes**, i.e that they were consciously trying to achieve the end of defeating the intent and application of the Act. ...
>
> [36] A natural and sensible reading of s 76 [of the GSTA], as it stood prior to 2000, is to read it as requiring the Commissioner to be satisfied that an arrangement has been entered into between persons "so as to" defeat the intent and application of the Act or any provision of the Act. **That requires the Commissioner and the Court to ask what objectively was the purpose of the arrangement, which in turn requires examination of the effect of the arrangement.** Section 76, even in its pre-2000 version, therefore requires an examination of the purpose or effect of the arrangement, and in this respect the current version of the section has merely stated expressly what was implicit in the former version.
>
> …
>
> [38] … the general anti avoidance provision was concerned not with the purpose of the parties, but with the purpose of the arrangement. That is a crucial distinction. Once you put the purpose of the parties to one side and seek by objective examination to find the purpose of the arrangement, you must necessarily do that by considering the effect which the arrangement has had — what it has achieved — and then, **by working backwards as it were from the effect, you are able to determine what objectively the arrangement must be taken to have had as its purpose.** That approach is inevitable once any subjective purpose or motive is ruled out of contention, as the authorities say it must be. [Emphasis added]

70. The High Court in *Henderson* confirmed that in s HD 15 of the ITA the purpose needs to be determined objectively:

> [64] **Here the determination of a purpose of an arrangement requires an objective examination. In deciding what the purpose or purposes of an arrangement are it is necessary to consider what it achieved, that is the end**

> **result. It must then be considered whether that was one of the things the arrangement was designed to achieve.**
>
> [65] I am satisfied that if any purpose of the arrangement was to have the effect of stripping assets from the company, so that they were unable to satisfy their liabilities to creditors (of which their tax liability is one), then that is a sufficient purpose for this requirement to be met. It is not necessary that the purpose is the dominant or principal purpose.
>
> [66] Here, the companies were insolvent at the relevant time. They could not pay both the GST and their other unsecured creditor, ILR. That part of the arrangement that involved disbursing the net sale proceeds to ILR (and subsequently to PVL and then its creditors and the creditors of its subsidiaries) left the companies with no assets. This resulted in them being unable to pay their GST liabilities. **Irrespective of the stated motive of the appellant, objectively that was the outcome of the arrangement, and that was the end result the arrangement was designed to achieve. It must be accepted therefore that it was a purpose of that part of the arrangement. It is reasonable to conclude therefore that an objective purpose of the arrangement was to have the effect that the companies could not meet their GST liabilities.**
>
> [67] Effectively here, the companies were insolvent at the time and it cannot be right that they can enter into arrangements as a result of which they receive windfall amounts they would otherwise not be entitled to and then use such amounts for their own purposes without paying their tax liabilities. [Emphasis added]

71. However, there is a key difference in the wording of s HD 15 of the ITA and the general anti-avoidance provision. Section HD 15(1)(c)(i) refers only to the relevant arrangement's purpose and requires that a purpose of the arrangement **is to have the effect** described in s HD 15(1)(b); that is, that the company cannot meet a tax liability. Section HD 15(1)(c)(i) does not require the purpose **to be** that effect (such an interpretation would render para (c) redundant and to the same effect as para (a)). The wording of s HD 15(1)(c)(i) suggests that the required purpose must be the arrangement's intended purpose; not simply the ultimate outcome. This is supported by the decision of the High Court in *Henderson*, where Gendall J referred to the "end result the arrangement was designed to achieve".

72. Whether the arrangement has the required purpose therefore involves considering whether the outcome or end result (effect) of the arrangement was what the arrangement was designed to achieve, objectively determined. This consideration will be highly fact specific.

73. Section HD 15(1)(c)(i) of the ITA uses an indefinite article in the phrase "**a** purpose of the arrangement" (emphasis added). This means it will be sufficient if any purpose of the arrangement was that the arrangement would have an effect involving the depletion of the assets of a company with the result that the company cannot meet an existing or future tax liability. It is not necessary for this purpose to have been the sole, dominant, or principal purpose.

74. This strongly suggests that ordinary business dealings – in terms of a company trading or entering into obligations in reliance of the safe harbour – will not generally be subject to s HD 15 of the ITA or s 61 of the GSTA. To the extent that such dealings – together with the decision to utilise the safe harbour – are an "arrangement entered into in relation to a company", it would not be reasonable to conclude that that arrangement alone had been designed with a purpose of the company being unable to pay a tax liability. This is supported by the fact it is a requirement of the safe harbour that a director be of the opinion, in good faith, that the company will be in a position to meet its debts on and after 30 September 2021.

75. We note, however, that the fact a company's directors decide to rely on the safe harbour will **not** prevent s HD 15 of the ITA or s 61 of the GSTA from applying to

any arrangement that would ordinarily be caught by the relevant provision. Any arrangement designed with a purpose of achieving the end result of avoiding a tax liability would still be subject to the application of s HD 15 or s 61.

Whether it is reasonable to conclude that a director could have anticipated the tax liability

76. The fourth requirement is that it is reasonable to conclude that if a director of the company at the time of the arrangement made reasonable inquiries they could have anticipated at the time that the tax liability would, or would likely, be required to be met (s HD 15(1)(c)(ii) of the ITA).

77. As noted above, whether something is reasonable involves an objective test and what is reasonable may vary depending on the factual situation. The inquiry for the purposes of s HD 15(1)(c)(ii) of the ITA is based on the circumstances that existed at the time of the arrangement.

78. It must be possible for the director to have anticipated that the tax liability would or would likely be required to be met. In *Commissioner of Police v Ombudsman* [1985] 1 NZLR 578 (HC) Jeffries J said (at 589) that the words "would be likely" as used in s 6 of the Official Information Act 1982 meant there was a distinct or significant possibility the result might occur:

> The words "would be likely" I consider mean that there is a distinct, or significant possibility the result might occur, but no higher than that. On the scale of probability it is above a slight chance and below an expectation. It suggests, in my view, without question mentally conceivable.

79. Adopting a similar approach to Jeffries J, for the purposes of s HD 15(1)(c)(ii), the director must have been able to anticipate that:
    - the relevant tax liability would be required to be met; or
    - there was a distinct or significant possibility that the relevant tax liability would be required to be met.

80. Of itself, this final requirement is not overly helpful in this context.

Conclusion

81. As set out above, for s HD 15 of the ITA (and therefore s 61 of the GSTA) to apply, four requirements must be satisfied:
    - An arrangement is entered into in relation to a company.
    - The arrangement has an effect that the company cannot meet a tax liability (either an existing liability or one that arises later).
    - It is reasonable to conclude that a purpose of the arrangement is that the company cannot meet or will not be able meet a tax liability.
    - It is reasonable to conclude that if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated that the tax liability would, or would likely, be required to be met.

82. Determining the effect and intended purpose of an arrangement is highly fact specific.

83. Considering the four requirements, for s HD 15 of the ITA or s 61 of the GSTA to apply, it is necessary for the arrangement to:
    - involve the depletion of the assets of a company; and

- be designed to have the effect that the company cannot pay a tax obligation.

84. Section HD 15 of the ITA or s 61 of the GSTA will not apply to a company that is unable to pay a tax obligation where:
    - the directors of a company facing significant liquidity problems because of the effects of COVID-19 and the resulting economic climate decide in good faith to rely on the safe harbour and continue carrying on business; or
    - as a result of the directors' decision to rely on the safe harbour, the company continues carrying on business and trading, or incurs new obligations on ordinary commercial business terms (for example, bank loans or sales at credit).

85. However, s HD 15 of the ITA and s 61 of the GSTA will still apply to any arrangement that would ordinarily be subject to the provision, notwithstanding that the arrangement was entered into during the safe harbour period following a company's directors' decision to rely on the safe harbour.

Examples

86. The following examples illustrate the general approach to the application of s HD 15 of the ITA and s 61 of the GSTA in the context of the COVID-19 safe harbour.

Example One: section HD 15 of the Income Tax Act 2007 does not apply

Shoe Co is a retail company that is facing significant liquidity problems due to the impact of COVID-19. The directors of Shoe Co seek advice from their lawyers. The lawyers advise that Shoe Co can continue trading on the basis that:

- the directors consider, in good faith, that Shoe Co is facing significant liquidity issues as a result of COVID-19;
- Shoe Co was able to pay its debts as they fell due in the normal course of business on 31 December 2019; and
- the directors consider, in good faith, that it is more likely than not that Shoe Co will be able to pay its debts as they fall due on and after 30 September 2021.

In May 2020, the directors resolve to keep trading and document their reliance on the safe harbour exemption. The directors are confident that the company will return to profitability within the next 18 months.

Shoe Co enters into a long-term loan with the bank so they have funds to pay staff and carry out important maintenance work. Shoe Co also negotiates an instalment arrangement with the Commissioner in relation to an income tax obligation that arose before New Zealand's COVID-19 lockdown.

Ultimately, these steps prove insufficient to save Shoe Co, and the directors resolve to place the company into liquidation. At that time, Shoe Co's assets are inadequate for it to fully meet its outstanding debts. Nearly half of the income tax obligation remains outstanding and cannot be paid.

Shoe Co has a tax liability that cannot be met, but there is no arrangement that has the purpose of depleting Shoe Co's assets in a way that is designed to have the effect that the tax liability could not be met. Accordingly, s HD 15 of the Income Tax Act 2007 does not apply.

Example Two: Section 61 of the Goods and Services Tax Act 1985 could apply

Food Co has operated a successful restaurant near a popular tourist spot for several years.

Food Co saw a significant downturn in business due to the impact of COVID-19. In May 2020, it was struggling to pay its debts as they became due. In June 2020, the directors of Food Co resolved to continue trading despite Food Co's financial difficulties, taking comfort that they were within the newly enacted safe harbour in schedule 12 of the Companies Act 1993. At that time, the directors were of the view, in good faith, that Food Co:

- was facing significant liquidity issues as a result of COVID-19;

- was able to pay its debts as they fell due in the normal course of business on 31 December 2019; and
- would return to profitability once overseas tourists were able to return, so it is more likely than not that Food Co will be able to pay its debts as they fall due on and after 30 September 2021.

Later in 2020, Food Co's situation has somewhat improved. The directors, however, remained concerned about the long-term prospects for Food Co. At that time, the directors resolve to sell the assets of the company to John, the sole shareholder in Food Co. Rather than selling the assets for market value, they resolve to sell them to John for a nominal sum. Following the sale, Food Co has insufficient funds to pay the GST owing on the sale of the assets (which is treated as have been made for open market value under s 10(3)).

The sale of the assets to John is an arrangement entered into in relation to Food Co that has the purpose of depleting Food Co's assets. An effect of the arrangement is that Food Co is unable to pay its GST obligations, as it has insufficient funds to fully pay the GST due on the sale of the assets. Objectively, that effect is a purpose of the arrangement, and therefore s 61 of the GSTA could apply.

References

Subject references

COVID-19 safe harbour
Directors' liability

Legislative references

Companies Act 1993, ss 135, 136, 138B, schedule 12
Goods and Services Tax Act 1985, s 61
Income Tax Act 1994, s HK 11
Income Tax Act 2004, s HK 11
Income Tax Act 2007, s HD 15
Official Information Act 1982, s 6
Tax Administration Act 1994, s 91D

Case references

AMP Life Ltd v CIR (2000) 19 NZTC 15,940 (HC)
Auckland Harbour Board v CIR (1999) 19 NZTC 15,433 (CA)
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CIR v Haenga (1985) 7 NZTC 5,198 (CA)
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"Tax recovery provision: Application to civil penalties and interest", *Tax Information Bulletin* Vol 17, No 7, (September 2005): 44

Appendix: Legislation

Income Tax Act 2007

1. Section HD 15 states:

HD 15 Asset stripping of companies

When this section applies

(1) This section applies when—

(a) an arrangement has been entered into in relation to a company; and

(b) an effect of the arrangement is that the company cannot meet a tax liability (the tax obligation) whether existing at the time of the arrangement or arising after that time, for—

(i) income tax:

(ii) a civil penalty, as defined in section 3(1) of the Tax Administration Act 1994:

(iii) an amount payable under Part 7 of that Act; and

(c) it is reasonable to conclude that—

(i) a purpose of the arrangement is to have the effect described in paragraph (b); and

(ii) if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the income tax liability would, or would likely, be required to be met.

When this section does not apply

(2) This section does not apply to an arrangement if—

(a) the Commissioner is a party to the arrangement:

(b) the tax obligation is no more than an amount of income tax that arises as a direct result of the performance of the arrangement, and that obligation has been met:

(c) at the time of the arrangement, the company was under statutory management under the Reserve Bank of New Zealand Act 1989 or the Corporations (Investigation and Management) Act 1989.

Director's liability

(3) All persons who are directors of the company at the time the arrangement is entered into are treated as agents of the company in relation to the tax obligation, and the liability is joint and several. But a director has no liability if—

(a) they do not derive a benefit from the arrangement, and at the first reasonable opportunity after becoming aware of the arrangement, or the aspects of the arrangement that cause this section to apply to it, they record formally their dissent in relation to the arrangement with the company and with the Commissioner; or

(b) they were not at the relevant time involved in the executive management of the company and had no knowledge of the arrangement, or the aspects of the arrangement that cause this section to apply to it.

Shareholder's liability

(4) A person who is a controlling shareholder or an interested shareholder at the time of the arrangement is treated as an agent of the company in relation to the tax obligation other than penalties and interest but, despite section HD 3(2), the liability is limited to the greater of—

(a) the market value of the person's direct and indirect shareholding in the company at the time of the arrangement; and

(b) the value of the benefit that the person derives from the arrangement.

Shareholder's liability for penalties and interest

(5) A person who is a controlling shareholder or an interested shareholder at the time of the arrangement is treated as an agent of the company in relation to penalties and interest in proportion to their liability for the tax obligation under subsection (4).

Company liquidations

(6) In order to give effect to this section, if a company has been liquidated, the Commissioner may at any time after the liquidation make an assessment of a company for an income tax liability of the company as if it had not been liquidated. The time bar applies, but this subsection overrides other provisions in this Act and the Tax Administration Act 1994.

Agents for purposes of notification or objection procedures

(7) In making an assessment under subsection (6), the Commissioner must nominate 1 or more persons as having the tax obligation set out in the assessment. The nominated person or persons are treated as agents of the company in relation to any notification or objection procedure concerning the assessment.

When liability does not arise

(8) No liability arises under this section for a tax year in relation to which—

(a) a company has provided returns within the time allowed by section 37 of the Tax Administration Act 1994 for providing returns for the tax year in which the company is liquidated; and

(b) the Commissioner has not issued a notice of assessment of the company for the tax year before the end of 4 years following the end of the tax year in which the company is liquidated.

Meaning of company in voting interest or market value interest tests

(8B) When applying sections YC 2 to YC 6 (which relate to voting and market value interests) for the purposes of the definitions of controlling shareholder and interested shareholder in subsection (9), the reference to company in sections YC 2 to YC 6 includes a company that is acting in the capacity of trustee.

Some definitions

(9) In this section,—

company includes a company that is acting in the capacity of trustee

controlling shareholder, for a company, means—

(a) a person whose voting interest or market value interest in the company at the time of the arrangement, together with any interests of an associated person, is 50% or more; and

(b) if the person or associated person is a company, the voting interest or market value interest of the person or associated person is calculated as if they were not a company and as if sections YC 4 (Look-through rule for corporate shareholders) and YC 6 did not apply

director means,—

(a) a person who occupies the position of director, whether or not the position has that title:

(b) for an entity that is treated as a company under this Act, a person who acts in the same or similar way as a director would if the entity were a company incorporated in New Zealand under the Companies Act 1993

interested shareholder means a person who, at the time the arrangement is entered into, has a voting interest or market value interest in the company, calculated in either case if the person is a company as if the person were not a company, and because of the size of the benefit that the person derives from the arrangement, it is reasonable to conclude that the person is a party to the arrangement

penalties and interest means a civil penalty or amount payable under Part 7 of the Tax Administration Act 1994 that is part of the tax obligation.

Goods and Services Tax Act 1985

2. Section 61 states:

61 Liability for tax payable by company left with insufficient assets

Section HD 15 of the Income Tax Act 2007, with any necessary modifications, applies for the purpose of this Act as if the terms income tax or tax read goods and services tax.

Companies Act 1993

3. Section 135 states:

135 Reckless trading

A director of a company must not—

(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or

(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

4. Section 136 states:

136 Duty in relation to obligations

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

5. Section 138B states:

138B Safe harbour for directors relating to effects of COVID-19

(1) The provisions of Schedule 12 have effect according to their terms.

(2) This section and Schedule 12 are repealed on the close of 31 May 2022.

6. Schedule 12 states:

Schedule 12

Safe harbour provisions relating to outbreak of COVID-19

1 Purpose of schedule

(1) The purpose of this schedule is to give to directors of companies that are facing significant liquidity problems because of the effects of the outbreak of COVID-19 more certainty about their duties when—

(a) agreeing to the business of the company being carried on or causing or allowing the business of the company to be carried on; and

(b) agreeing to the company incurring obligations.

(2) However, it is not a purpose of this schedule to facilitate the ability of a company that has no realistic prospect of continuing to trade or operate in the medium or long term to defer a decision to enter into liquidation to the detriment of its creditors.

2 Overview of schedule

(1) This schedule applies in relation to actions of directors of certain companies during safe harbour periods.

(2) Subclause (1) is only a guide to the overall scheme and effect of this schedule.

3 Interpretation

In this schedule, unless the context otherwise requires,—

action includes omission

commencement date means the commencement date of section 138B

company in BDH means a company to which the protections in Part 5 of Schedule 13 apply

Ministers means the Minister of Finance and the Minister of the Crown who, under the authority of a warrant or with the authority of the Prime Minister, is responsible for the administration of this Act, acting jointly

reaching a compromise or other arrangement includes a proposed arrangement being approved by the company's creditors under Schedule 13

safe harbour period has the meaning set out in clause 5.

Application of safe harbour provisions

4 Companies to which safe harbour provisions apply

(1) Clauses 6 and 7 apply to a company (including a company in BDH) if,—

(a) as at 31 December 2019 (or any later benchmark date prescribed in regulations for a new safe harbour period), the company was able to pay its debts as they became due in the normal course of business; or

(b) the company was incorporated on or after 1 January 2020 but before 3 April 2020.

(2) However, clauses 6 and 7 do not apply to a company that is—

(a) a registered bank within the meaning of section 2(1) of the Reserve Bank of New Zealand Act 1989:

(b) a licensed insurer:

(c) an NBDT within the meaning of section 5 of the Non-bank Deposit Takers Act 2013:

(d) a qualifying counterparty within the meaning of section 122A of the Reserve Bank of New Zealand Act 1989:

(e) a company incorporated on or after 3 April 2020:

(f) a company of a class prescribed in any regulations made under clause 9.

(3) In addition, clauses 6 and 7—

(a) do not apply in the circumstances, or to the transactions, prescribed in any regulations made under clause 9; and

(b) cease to apply if conditions prescribed in any regulations made under clause 9 are not satisfied.

5 Meaning of safe harbour period

(1) In this schedule, safe harbour period means—

(a) the initial safe harbour period; and

(b) if regulations are made under clause 10(1)(b), the new safe harbour period.

(2) The initial safe harbour period means the period that starts on 3 April 2020 and ends—

(a) on the close of 30 September 2020; or

(b) if regulations are made under clause 10(1)(a), on the close of the date to which the period is extended.

(3) The new safe harbour period means the period prescribed in the regulations made under clause 10(1)(b).

Safe harbour provisions

6 Safe harbour relating to reckless trading

(1) This clause applies to the following actions of a director of a company taken during a safe harbour period:

(a) agreeing to the business of the company being carried on in any manner:

(b) causing or allowing the business of the company to be carried on in any manner.

(2) The actions of the director do not breach section 135 if, at the time of taking them, the director, in good faith, is of the opinion that—

(a) the company has, or in the next 6 months is likely to have, significant liquidity problems; and

(b) the liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and

(c) it is more likely than not that the company will be able to pay its due debts on and after the date in subclause (3).

(3) For the purposes of subclause (2)(c), the date is—

(a) 30 September 2021; or

(b) any later date prescribed by the regulations.

(4) For the purposes of the opinion required by subclause (2)(c), the director may have regard to—

(a) the likelihood of trading conditions improving:

(b) the likelihood of the company reaching a compromise or other arrangement with its creditors:

(c) any other matters the director considers to be relevant.

(5) In this clause, regulations means regulations made under clause 10.

(6) See clause 4, for companies to which this clause applies.

7 Safe harbour relating to section 136 duty

(1) Subclause (2) applies to a director of a company—

(a) who, during a safe harbour period, agrees to the company incurring an obligation; and

(b) who, at the time of agreeing to the company incurring the obligation, is, in good faith, of the opinion that the company has, or in the next 6 months is likely to have, significant liquidity problems.

(2) For the purposes of section 136, the director has reasonable grounds to believe that the company will be able to perform the obligation when it is required to do so if the director, in good faith, is of the opinion that—

(a) the liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and

(b) it is more likely than not that the company will be able to pay its due debts on and after the date in subclause (4).

(3) However, subclause (2) only applies if the company incurs the obligation in the safe harbour period.

(4) For the purposes of subclause (2)(b), the date is—

(a) 30 September 2021; or

(b) any later date prescribed by the regulations.

(5) For the purposes of the opinion required by subclause (2)(b), the director may have regard to—

(a) the likelihood of trading conditions improving:

(b) the likelihood of the company reaching a compromise or other arrangement with its creditors:

(c) any other matters the director considers to be relevant.

(6) In this clause, regulations means regulations made under clause 10.

(7) See clause 4, for companies to which this clause applies.

Miscellaneous

8 Burden of proof

A person who wishes to rely on a provision of this schedule in a proceeding for, or relating to, a breach of section 135 or 136 has the burden of proving that the provision applies.

9 Regulations relating to companies, etc, to which safe harbour provisions apply

(1) The Governor-General may, by Order in Council made on the recommendation of the Ministers, make regulations that prescribe classes of companies, or classes of transactions or other circumstances, for the purposes of clause 4, including providing for either or both of the following:

(a) for clause 6 or 7, or both, to apply only if conditions prescribed in the regulations are satisfied:

(b) for clause 6 or 7, or both, to cease to apply if conditions prescribed in the regulations are not satisfied.

(2) Before recommending the making of regulations under subclause (1), the Ministers must have regard to—

(a) the provisions of clause 1 (which relates to the purpose of this schedule); and

(b) the effect of the regulations on—

(i) the creditors of companies that have significant liquidity problems; and

(ii) the integrity of corporate insolvency law.

(3) Different matters may be prescribed in respect of different classes of companies, transactions, or other circumstances.

(4) See also clause 10 (for regulations prescribing a benchmark date).

10 Regulations relating to safe harbour periods

(1) The Governor-General may, by Order in Council made on the recommendation of the Ministers, make regulations that—

(a) extend the initial safe harbour period until no later than 31 March 2021:

(b) provide for clause 6 or 7, or both, to apply for a new safe harbour period—

(i) of no more than 6 months; and

(ii) that ends no later than the close of 30 September 2021.

(2) The powers in subclause (1)(a) and (b) may each be exercised once only.

(3) However, the Governor-General may, by Order in Council made on the recommendation of the Ministers,—

(a) revoke regulations made under subclause (1) (wholly or in part):

(b) amend regulations made under subclause (1) to reduce the period of an extension or a new safe harbour period.

(4) The Ministers must not recommend the making of regulations under subclause (1) unless the Ministers—

(a) have had regard to the provisions of clause 1 (which relates to the purpose of this schedule); and

(b) are satisfied that the extension or new safe harbour period is—

(i) necessary or desirable to address the effects of COVID-19; and

(ii) no longer than is reasonably necessary to address the matters that gave rise to it.

(5) Regulations made under subclause (1)(a) may prescribe a date for the purposes of clauses 6(3) and 7(4), but that date must be no later than 31 March 2022.

(6) Regulations made under subclause (1)(b) may do either or both of the following:

(a) prescribe a benchmark date under clause 4(1)(a), being a date that is—

(i) no earlier than 30 June 2020; and

(ii) no later than the date that is 3 months before the start of the new safe harbour period:

(b) prescribe a date, for the purposes of clauses 6(3) and 7(4), but that date must be not later than 18 months after the start of the new safe harbour period.

(7) Subclauses (5) and (6) do not limit subclause (1).