waterline

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INSOLVENCY

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INSIDE:

Hiding in Plain Sight; Who is Liable for Ross Asset Management?

Officers maybe, Gentleman, certainly not!

It has been a long accepted tradition that liquidators are officers of the court. This, however, should not be taken that the court holds liquidators in high esteem.

Quite the reverse, as Justice Heath demonstrated last year.

Prior to the 1993 revision of the Companies Act there was a distinction between court and voluntary liquidators, with the former held to a high standard and the later left relatively unsupervised.

The distinction was removed in 1993 and all liquidators, regardless of how they were appointed, were brought under the explicit jurisdiction of the High Court. The significance of this change escaped the legal and insolvency professions attention until last year when Justice Heath turned his mind to the matter.

On one side was David Chisholm QC, valiantly representing liquidators Sheahan and Lock, and on the other Murray Tingey representing the ANZ Bank and one of her officers.

At issue was the conduct of the Australian based liquidators who were simultaneously liquidators of Cedenco in Australia and separate Cedenco companies in New Zealand. As liquidators in New Zealand they interviewed the ANZ Bank officer, ostensibly for the purpose of pursuing the New Zealand liquidation but they later used the transcript as evidence in Australian litigation.

The conduct of the liquidators was challenged. They protested that the High Court lacked jurisdiction because they were shareholder and not court appointees.

Chisholm QC contended that shareholder appointed liquidators were not officers of the court and outside the court's watchful gaze. Tingey responded that the 1993 legislation extended the courts' supervision over all liquidators and the distinction was no longer relevant.

Careful in his words, Heath was reluctant to elevate liquidators to being officers of the court, saying instead:

> *I am satisfied that the intention of the Parliament...was to put all liquidators on an equal footing...It does not matter whether Parliament intended to characterise all liquidators as "officers" of the Court. The fundamental point is that Parliament intended that this Court exercise a general supervisory and... summary jurisdiction over them, in a manner akin to the Court's supervision of one of its "officers".*

Heath found that the use of the transcript in Australia litigation was inappropriate; but given that the two liquidators were resident in South Australia they were outside his jurisdiction. There was little he could do but express his dissatisfaction.

Under NZICA's umbrella

Parliament is inching to a form of registration for insolvency practitioners. The Legislation is likely to gain Royal Assent early in the New Year.

Liquidators will need to be registered although the criteria is low; being over 18 is sufficient. However, the bill allows for several exclusions, specifically;

- Under the control of the Mental Health Act
- Has been expelled or suspended by either a legal or accounting professional body
- Is insolvent or bankrupt
- Has a conviction for dishonesty
- Is currently a banned director

A potential liquidator captured by these exclusions can apply to the High Court for an exception. The act allows for a three month stand down from enactment until registration becomes effective.

There will be a searchable database of registered insolvency practitioners maintained by The Registrar of Companies, will also have the power to remove liquidators from the roll for repeated or serious misconduct. This gives him an effective oversight function that is currently limited to the courts.

Under current legislation, people seeking appointment as a Voluntary Administer must prepare an Interests Register that records any commercial or other contacts between the Administrator and the company in Administration that extends to any personal relationship. This requirement will be extended to liquidators.

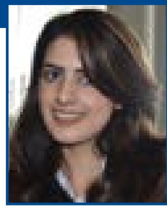
Some in the industry feel that Parliament's registration regime is not sufficiently robust and INSOL, the special interests committee of the Institute of Chartered Accountants, has decided to create their own standard, to be called Accredited Insolvency Practitioners. The standard is more onerous than the regime being proposed by Parliament, with candidates being asked to demonstrate;

- Three years graduate study
- 2,000 hours of practical insolvency experience in the previous three years
- Pass a good character test
- Have sufficient insurance requirements relative to the size of the practice

This program will be open to existing NZICA members but also those who are not Chartered Accountants but who are willing to be bound by the Institutes rules and ethics.

Insol plans to have their regime up and running by the middle of 2014, about the same time as the Parliament's regime comes into force.

The insolvent corporate trustee and its right of indemnity



By Jesvin Boparoy, In-House Counsel

Corporate trustees have become a common vehicle for carrying on business ventures in New Zealand. Usually, the corporate trustee would be a limited liability asset-less company who trades on behalf of the trust and will incur debts and liabilities. While a corporate trustee will hold the legal title to trust assets, these assets are considered to be property of the beneficiaries under the law of equity.

Corporate trustee's right of action against trust assets

Creditors of a company are not allowed to pursue the trust or its assets directly and must pursue the corporate trustee to enforce its right of recovery. There is a misconception that the use of a corporate trustee will provide a barrier of insolvency protection against creditors enforcing their rights over trust assets belonging to beneficiaries. In the event of its liquidation, the corporate trustee's liquidator can enforce its right of indemnity against trust assets in order to satisfy trust liabilities.

A corporate trustee's right of indemnity stems from both a statutory right under section 38(2) of the Trustees Act 1956 and an equitable right under the common law. In essence, a liquidator through the corporate trustee will have an equitable lien over trust assets. The lien has with it a right of sale.

Because a corporate trustee's right of indemnity arises by operation of law, it is not necessary that this equitable interest to trust assets be registered on the Personal Properties Securities Register (PPSR). As a general rule, a corporate trustee's rights would have priority over beneficiaries and unsecured creditors but would rank behind secured creditors. The Companies Act 1993 preferential creditor's regime does not apply to trust property. Section 312 of the Companies Act 1993 refers to the order of distribution in relation to assets of the company. Such assets cannot include assets held in trust which will be distributed according to the equitable principles of the courts.

Similarly a trading trust cannot avoid liability for trading debts due to the removal of a corporate trustee or the appointment of a liquidator. This is because the right to indemnity is treated as an equitable non-possessory lien. Because the right is not possessory, the corporate trustee will still have an interest in the trust fund notwithstanding that it may now be removed or replaced as a trustee.

Corporate Trustee's right of action against beneficiary

Where the trust property is insufficient to meet the corporate trustee's right of indemnity, the corporate trustee may be entitled to an indemnity from the beneficiaries under the trust. The obligation of the beneficiary to indemnify the corporate trustee is founded on the principle that the person who gets the benefit of a trust should share its burden. Accordingly, the indemnity can only be enforced against beneficiaries who are absolutely entitled and cannot be exercised against those beneficiaries who are merely discretionary.

The exception to the indemnity being that if the loss was the result of the corporate trustee's own fraudulent conduct or if it was outside the scope of the corporate trustee's authorised activities.

Further, it is not necessary for the trustee to have paid or discharge its liabilities in order to enforce it. The focus is on the right to indemnity rather than a right to recovery.

Disposition of trust assets

In circumstances where trust assets have been disposed of to the beneficiaries before the appointment of the liquidator, sections 334 to 335 of the Property Law Act 2007 governs this position.

Where a disposition is made with the intention of prejudicing the creditors in the liquidation, or without receiving equivalent value in exchange, a liquidator can apply to the Court to set it aside as a voidable disposition pursuant to section 348 of the Property Law Act 2007.

For the subpart to apply there must be an actual intention to prejudice the creditor. Property disposed of in good faith will not be captured by these provisions. Often liquidators will need to examine who the directors are of the respective entities involved in a property transfer where an insolvent trading trust is concerned. If there is a common director to each entity, then potential causes of action under section 348 of the Property Law Act 2007 may arise.

To date, trust law in New Zealand has had very little regulation and it is difficult for creditors and liquidators alike to assess whether a trust is being administered properly. The Law Commission has suggested in its September 2013 submissions for a move towards trust regulation and reporting requirements.

One suggestion put forward is the implementation of a searchable register of trading trusts in New Zealand. This would allow potential creditors to find out if the company they are dealing with is a trustee and whether property is held for beneficiaries in the company's capacity as trustee. Without a registration regime, it is difficult to obtain information about these trading trusts. Arguably it would be the creditor's responsibility to search the register to protect its position. Whether Parliament would be inclined to move towards the regulation of trusts is a matter that all practitioners and liquidators alike are interested to see.

Voiding the Revenue

The IRD can be a scary organisation. They have limitless resources and an appetite for litigation, so it was with some temerity that we brought to their attention a small voidable we think we had against them.

Prior to its liquidation Quantum Grow had entered into a payment arrangement for tax arrears. We had an order from the Employment Relations Authority in favour of two staff that in our view ranked ahead of the Commissioner.

The amount of money that was owed to the staff was voidable, we suggested. Politely. The Commissioner wrote back, correcting us, as some of the claim was for wages going back over four months. Staff rank ahead of the IRD only for unpaid wages in the last four months prior to liquidation.

We corrected our numbers and after some gentle persuasion, it was agreed that the funds would be released on condition that it would be paid to the staff without the liquidators squandering any of it on frivolous nonsense; such as liquidator's fees.

This seem a fair deal. The amount of money wasn't large but a nice bonus this side of Christmas for the staff involved.

Getting RAMed

The collapse of David Ross's Ross Asset Management (RAM) has created a half billion hole in the personal wealth of several hundred investors. It is New Zealand's largest Ponzi scheme and one of our nation's most impressive frauds.

There are a number of issues that arise, the first being, who is a creditor?

Because there was some limited investing done the liquidators, PwC, do not believe that RAM meets the definition of a Ponzi. However, there were Ponzi-like elements; the key being new investors money was used to pay 'dividends' to existing investors.

Many investors received all of their capital back but they hold paper-returns from RAM that shows they are still owed funds. This is in contrast to those who invested and got back less than their investment, or nothing.

Jake invested in RAM in 2008, and he took his cash out two years later. In that time he nominally earned $10 in interest. He took out $5 in the first year, the second $5 is still owing, which he believes he is entitled to, and so claims for this in the liquidation.

Jake is a 'net winner', at least relatively to Cathy.

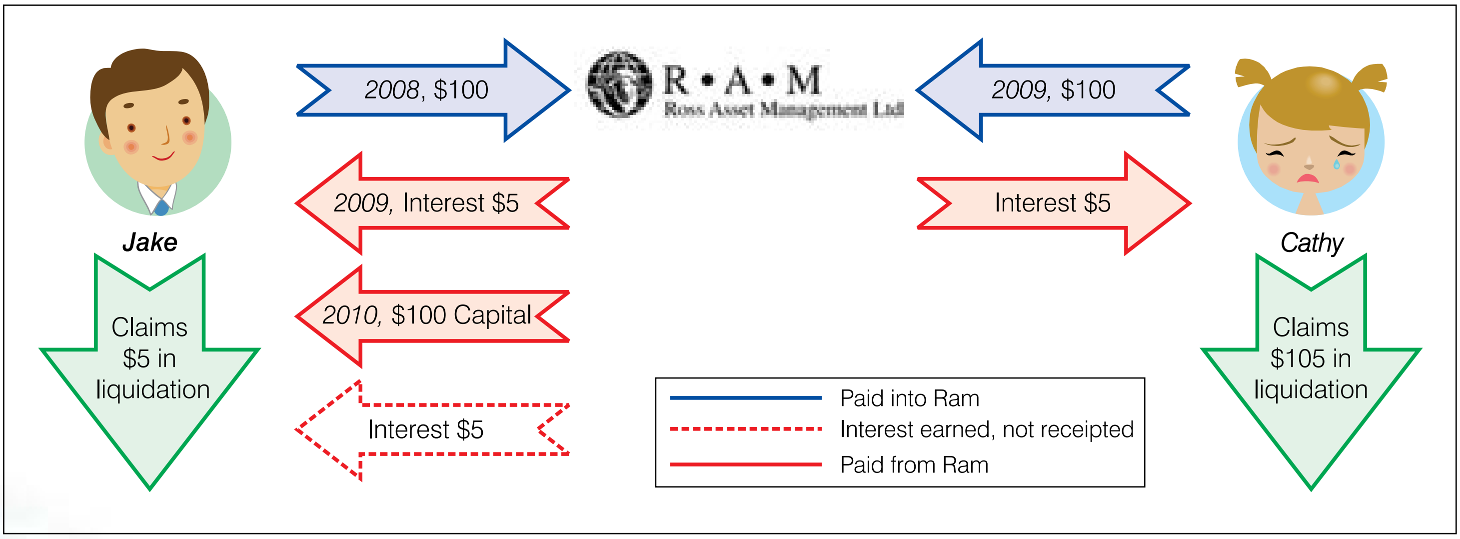
Cathy invested in 2009 and it was her funds that formed part of the new money that RAM used to repay Jake. Cathy might feel that her money was effectively stolen and given to Jake. Cathy is a 'net loser'

Is Jake a creditor?

Picard has a critical advantage because Maddoff's company, Bernard L Madoff Investment Securities, was a brokerage covered by the United States Securities Income Protection Act that provides funding in the event that a brokerage fails. The regime is managed by the Securities Investor Protection Corporation, a statutory member-funded body that to date has paid Picard $800m in fees for his recovery efforts. This, it should be mentioned, is more than the entire New Zealand insolvency industry has claimed in fees in the last decade, possibly the last two decades.

Picard has five lines of attack. The following page shows them with their New Zealand equivalent.

Picard's major defeat, as outlined overleaf, was against a series of banks, first amongst them being JP Morgan Chase.



These two can be classed into 'net winners' and 'net losers'. According to PwC's reports there are roughly;

627 net losers; total losses $114,229,000

204 net winners; total winnings $46,365,000

This is only those who had open portfolios at the time RAM went into receivership. It is possible that there were more net winners who, over the years, had cashed out and whose details have yet to emerge. In theory, if you took the $46m from the winners and distributed it to the losers, the later would get a 40% recovery.

Bruce Tichbon, who represents the RAM investors group (RAMIG), believes there needs to be an investigation of whether net winners are creditors under the Companies Act and should therefore be excluded from participating in the liquidation. However, the liquidators, appear to have taken the less confrontational approach and included them. This makes sense, especially if there ends up being nothing to distribute because it avoids a passionate but pointless debate.

A liquidator can accept a proof of debt but elect to reject later. If there is ever to be a distribution from RAM, expect this to be a major issue.

So, where to from here?

Piccard is the court appointed trustee of the Madoff Ponzi and has reached settlements of 9.5 billion in a Ponzi worth 17.5 billion. An impressive 4.5 billion has been paid out.

Picard claimed that the banks enabled the fraud because they either did know or should have known what its client was up to and are therefore liable. Courts in New York rejected this because Picard is standing in the soiled shoes of Mr Madoff. The legal principle, in pari delicto or mutual fault, translates in New Zealand as 'Clean Hands.' One party to a fraud cannot sue another party for their loss.

A party must, the courts ruled, exercise their own legal rights and not rely on third parties. The investors can sue, and still might, but the Trustee could not sue on their behalf. The issue is being sent to the Supreme Court.

The banks did not concede that they did have knowledge but the case did not hinge on that point.

Assuming any external agency had any liability (and that is highly uncertain) would the New Zealand liquidators fare better than the American Trustee when the case got in front of a judge?

Our courts do treat a liquidator as being a separate entity from the company and a liquidator has powers that a director doesn't, including the powers to interview the failed firms officers and professional advisors under oath, as well as claw back payments deemed to be voidable. A company can sue its director for losses that the director caused to the company, so it is possible that a court would entertain a claim by a liquidator suing a third party on the basis that the fraud committed by the director caused losses directly to the company.

There are at least three possible litigation targets;

a) *The bank(s) RAM traded with*
   There would need to be evidence that his bank knew or should have known David Ross was running a Ponzi. He had nearly half a billion under management, but did his bank know the size of his portfolio? Did the bank's account manager meet with him, review his accounts, what do their internal records say? The liquidators are entitled to gain this information or apply to the courts to get it.

b) *The Institute of Chartered Accounts NZICA*
   David Ross was a member of the institute, but he was not offering accounting services to the public and was therefore not required to submit to a practice review. That might not get the Institute off the hook if they had suspicions but did nothing.

c) *The Securities Commission and its successor the FMA*
   Holding the Securities Commission liable would be like holding the police liable because someone robbed your house. They would need to have had specific knowledge of his offending or that evidence should have been easily available. In any event, this is a very uncertain liability issue.

   The FMA is in a more delicate position, because they gave Ross a license as a Financial Advisor. Helpfully for the FMA, the scam was noticed shortly afterwards so any liability is likely to be limited to any new funds invested during that short period and only if negligence can be proven. Even then, did the new investor rely on the fact Ross was a licensed advisor?

	MADOFF	RAM
1	*Tax Paid on Fictional Interest; The Internal Revenue Service $326m* Picard claimed that Madoff had paid to the IRS tax on interest earned by overseas investors. However, because there was no actual interest earned, there was no tax due and the IRS repaid the money.	*Interest on Unpaid Tax* The IRD has issued a technical document that appears to allow individual investors to claim refunds from the IRD for deductions made on their behalf when in fact there was no interest actually paid. This is a win for the net losers, as they get some of their money back directly. The cash does not go into the liquidation.
2	*Net Winners; Carl Shapiro $625m* An early investor with Madoff, there was no evidence that Shapiro, who celebrated his 100th birthday this year, knew Madoff was a Fraud. However, Picard claimed that Shapiro, who was a high profile Boston Philanthropist, benefitted from the Ponzi and claimed more than a billion back from him. The settlement with Shapiro was significant because of the lack of direct evidence that Shapiro knew of the Ponzi, but he settled for most of the net profits he enjoyed from his involvement with his life-time friend, Bernie Madoff. The Trustee, in pursuing those who that benefitted, albeit honestly, from the scam defined his approach as: *"Those who have received other people's money, irrespective of their knowledge of the fraud, should return the monies to the Trustee for payment to those Madoff customers with valid claims who have returned little of none of their original deposits."*	*Net Winners; Voidable Transactions* To date only $3.8m of the $46m has been identified as recoverable under the voidable transactions law. The rest, presumably, was taken out before the two year limit on insolvent transactions. A transaction over two years cannot be clawed back Those caught in the two year period are in a very difficult position. The transactions are clearly voidable given RAM's financial position and any payments out did give rise to a preference. They will need to fall back to the defences available under 296. Most will be able to show they acted in good faith and did not suspect that RAM was a Ponzi scheme but under current case law, being Fences and Kerbs, they did not provide value. Unless they can construct some argument that they altered their position, these investors will need to return the 3.8m.
3	*Fraudulent Conveyance; Jeffrey Picower $5b* Another associate of Madoff, Picower was believed to have either had knowledge or should have had knowledge of the fraud. He was a long time investor and his returns were, according to Picard, 'implausibly high'. Picower died of a heart attack in his pool and drowned a year after the fraud was exposed. His estate settled the claim for $7.2 billion, with an additional $2.2b going to the US government also to be used to repay Madoff's victims.	*Fraudulent Conveyance; Constructive Trusts* PwC, in their reports, have indicated that they are looking at the possibility that some of the net winners maybe subject to a constructive trust argument, however, no cases appear to have been brought to date. Timing here becomes important. The standard limit under the Limitation Act is six years from the time that the default occurred and the liquidation is now over a year old. However, if the liquidators can show that this is a trust issue, which might be difficult, then the limit extends to 12 years. In a scheme running two decades however, time is money!
4	*The Feeder Funds; Tremont Group $1b* Tremont was a 'feeder fund' that encouraged clients to invest with Madoff. The allegation as that Tremont ignored evidence that indicated Madoff could have been running a fraud and was therefore negligent in continuing to recommend his fund to clients.	*The Feeder Funds; Financial Advisors* It is possible that the financial advisors who recommended RAM to their clients may face liability here. This was certainly the case in the Blue Chip liquidation, but in that case it was the clients themselves who took the action, and the same case would apply here. It is possible that the advisors have a liability to the company itself but this is unclear.
5	*The Banks* • Picard lost this fight • He is appealing	*Banks and others* • RAM's bankers • NZICA and the Regulators

Go to passport control; do not ignore director's duties

Section 261 of the Companies Act allows a liquidator to compel a person who has knowledge of the affairs of the company to produce the company's documents and to attend an interview under oath.

Not everyone is excited about the opportunity. One of the more challenging we faced recently was a director of a company we were liquidators of, Capital Hospitality Limited, who maintained, that he was in India.

The gentleman in question, Mr Rai, was also a director of another company subject to a 261 notice, Capital Investment Corporation Limited.

Mr Rai protested the jurisdiction of the New Zealand courts because he was overseas. Capital Investment protested likewise because its director was overseas.

Undeterred, and suspecting that the director may have confused the Sub-Continent with the western suburbs, we went to court. The first issue was easy; a company subject to a 261 notice does not escape jurisdiction simply because its director elects to remove himself from the country. The second caused the court to ponder a bit deeper.

The defence claimed that a liquidator could take recourse to the cross-border insolvency legislation, UNCITRAL. We weren't excited about that. In any event, Associate Judge Bell, on his own research, determined that India had not passed the UNCITRAL law.

Bell then decided the matter in a phrase that we suspect will be quoted again;

> *Just as directors can exercise powers of management... while outside the country…a director is not relieved of his duties when he goes through passport control.*

A person who elects to become a company director submits themselves to the jurisdiction of the New Zealand courts, no matter where they live.

Getting the director to personally pay

A common assumption by creditors who are seeking to get paid is to get a payment from the director, in the mistaken belief that such a payment will be safe from a liquidator.

They are wrong.

If a payment was made by a director the courts will look at that payment as being one made by the director on behalf of the company. This issue was canvassed directly in the last year of the last century.

Pony Express Limited's account with the National Bank was overdrawn and the bank had a personal guarantee against the shareholders. In the weeks before liquidation the directors deposited $22,000 of their own money to reduce the overdraft.

The liquidator sought to claw it back.

The Bank claimed that this was the shareholder's money, not that of the company. The Court disagreed, saying:

> *I have no doubt but for the intervention of liquidation, the advance would have been recorded as such in the books of the company with a corresponding increase in the current accounts.*

The court went further, considering that the position of the company had not been improved, because it had swapped a debt to the bank to one to the shareholders, and ordered the $22,000 be paid to the liquidators.

The liquidators for Pony Express raided the National Bank

Despite this, creditors seeking to get paid should not shy away from taking payment from the director in settlement for a company debt. It is important to remember that this payment will only become voidable if the company falls into liquidation within two years after the impugned payment was receipted. It is common for firms in financial difficulty to trade their way out of trouble. It is also important to remember that if you are paid at the time you provided goods and services to a company, payment equal to the value of the work provided will not be voidable.

Our Mascot Prudence in Tiananmen Square; Beijing.

Six of the best

By Brent Norling, In-House Counsel

Director's duties are like clean underwear. They only matter if you lose your pants. Let's re-examine them;

1) To act in good faith and in best interests of company (s131);

2) To exercise their powers for proper purpose (s133);

3) To comply with Act and constitution (s134);

4) Not to trade the company recklessly (s135);

5) Not to agree to the company incurring an obligation unless the director believes *...that the company will be able to perform the obligation...* (s136); and

6) To exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances (s137).

If one of these are breached and the company fails the director may find themselves being held personally liable. The test is objective – the Courts are uninterested in what the director thought but will analyse what a reasonably prudent director would have done in the circumstances.

One question is, once things start to go bad, when does the director's liability begin?

Bad Syntax

This issue was explored in *Syntax Holdings (Auckland) Ltd (in Liq) v Bishop [2013]* NZHC 2171. Syntax was a BB's coffee store in DressSmart in Onehunga. The company began to miss IRD payments in late 2008 and fell into liquidation with Deloitte as liquidators in September 2011 owing $412,000 to its creditors, including $165,000 to the IRD.

In order to prove insolvency, David Levin, one of the liquidators, provided evidence that the debt to the IRD continued to grow. In the absence of any other evidence, the court accepted that;

> *I accept Mr Levin's evidence that "a failure to pay GST and PAYE on a regular basis is a sure sign of a company in trouble" because "these funds are only ever meant to be held" by a company "for a short period of time prior to payment to" the Commissioner of Inland Revenue. The funds have a quasi-trust character to them.*

As is usual, the Court split the analysis of liability and quantum.

Question of liability

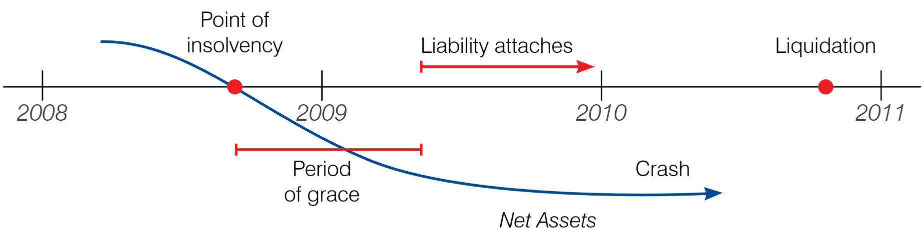
The directors were held to have allowed the business of the company to be carried on from 1 April 2009 in a manner likely to create substantial risk of serious loss to the company's creditors.

By drawing a line at 1 April 2009 as the date where the directors were reckless, the Court gave the directors a period of six months to take stock of the situation, taking as a starting point the recession when tax payments began to be missed. The directors had an ability to arrest further indebtedness by making an assessment of the business prospects but they failed to do so.

Question of quantum

Three points are relevant to this question: culpability of the directors, duration of the breaches and the causal link between the breaches and the indebtedness.

The duration of culpability was from 1 April 2009 to the date of liquidation. During that period Syntax continued to incur debt. No attempts were made to meet taxation debt, so interest and penalties continued to accrue.



As at 1 April 2009 total creditors were $60,540. Deducting that sum from the outstanding amount of unsecured creditors at the date of liquidation, $412,407, leaves a figure of $351,867 which the Court rounded to $350,000. The Court then made an allowance of $50,000 to reflect what was recovered by way of voidable transactions by the liquidators. That left a total of $300,000. The Court then made a further allowance for the benefit of the directors of 20%. Judgment was entered for an amount equating to 80% of $300,000, namely $240,000.

SYNTAX Director's Liability

$410,000; Total Liability at Liquidaiton

Less $60,000
Amount owing to creditors when reckless trading began

Less $50,000
Amount of voidables recovered by liquidators

Less $60,000
Credit given to directors

$240,000

Extent of director's personal liability

Key take outs

A company structure allows individuals to trade with limited liability to their personal capacity. In order to enjoy this limited liability, directors need to take prudent steps in the management of the company.

A key indicator that a company is in trouble is when the company utilises the Commissioner of Inland Revenue as a lender of last resort. If the Commissioner is not being paid, it is time to take a sober assessment of the business.

Driving a truck through Schedule Seven

We like to imagine that laws are written by wise men and women, carefully balancing different and complex issues. The truth is that the task falls to graduates plucked from the halls of academia, most of them not knowing custard from clay.


Custard


Clay

Their ideas are mashed together, hurled at a select committee for the public to submit on and be ignored before a half-empty house 'yays' the bill into law. It is messy, but, like making sausage, the end result isn't always too bad.

However, this process sometimes creates ambiguity which is left to the legal-paying public and the judiciary to unravel. This issue at hand here is Section 167 of the Tax Administration Act that creates a trust for the PAYE deductions. The wording is vague and proved wide enough for the IRD to drive a truck through; a Jennings Truck, as it happens.

The liquidation in question was Jennings Road freighters.

The IRD had been grumpy with Jennings and invoked its power under Section 157 of the Tax Administration Act to compel Jennings' bank, the BNZ, to withhold funds. Within days Jennings fell into liquidation and the tussle over the $14k held by the BNZ began.

The IRD claimed that the money was PAYE money held in trust. The liquidators said any trust ceased upon liquidation and Schedule Seven applied. This is really an issue over liquidator's fees, because only our fees rank ahead of the Commissioner for assets like cash in the bank.

Round one went to the liquidators. Associate Judge Doogue found that the trust established under Section 167 of the Tax Administration act ended at liquidation, but two out of three Court of Appeal judges disagreed with Doogue.

The problem is in the very similar wording of Section 167(1) and 167(2) of the Tax Administration Act.

167 Recovery of tax and payments from employers

(1) *Every amount of tax ...withheld or deducted under the PAYE ... shall be held in trust for the Crown ...and, in the event of the bankruptcy or liquidation of the employer ... shall remain apart, and form no part of the estate in bankruptcy, liquidation...*

Court of Appeal interprets as: PAYE deducted but not paid to the IRD is held in trust; it is no longer the Company's money and on liquidation goes to the IRD.

(2) *When an amount of tax ... has been withheld or deducted under the PAYE rules and... the employer has failed to deal with the amount of the tax or payment withheld or deducted (or any part of it) in the manner required ... the amount of the tax or payment for the time being unpaid ..... shall...rank as follows:*

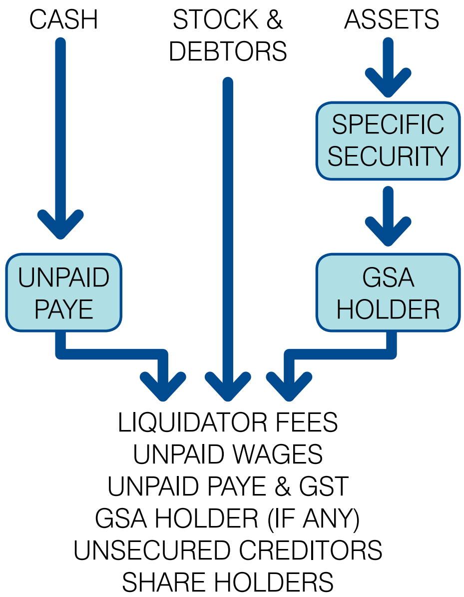
(b) *.... the amount of the tax or payment shall have the ranking provided for in Schedule 7 of the Companies Act ...*

Court of Appeal interprets as: PAYE deducted but spent elsewhere is held in trust but the trust ends on liquidation and this money forms part of the liquidation.

The significant difference is the words; *"failed to deal with the amount .. deducted.. in the manner required ..."*

Money held in the bank belongs to the Commissioner if there is unpaid PAYE. This decision raises a number of questions and the liquidators, McDonald Vague, are appealing it to the Supreme Court.

As the law stands, however, it appears that this trust is limited. It only applies to cash held by company at the time the PAYE debt was created. Money received after this date is not, in Waterstone's interpretation of this decision, held in trust.



Example One; Wages are paid on the 1st of the month, and PAYE due on the 20th. If the company receives money on the 22nd but goes into liquidation on the 23rd this new money, clearly not 'deducted' or set aside by the company, is not held in trust for the Commissioner.

Example Two; Wages are paid on the 1st of the month, and PAYE due on the 20th. The bank account fell to zero between the 1st and the 18th, but new money came into the account on the 19th. This was not paid to the IRD, but remained in the company's account on the 23rd when the liquidators were appointed. This new money, up to the value of the PAYE debt due on the 20th, is held in trust for the Commissioner.

Example Three; Outstanding PAYE was $10,000 on the 1st of the month. Wages are paid on that date, increasing the PAYE liability to $12,000. The bank account is empty after the wages are paid. $15,000 in new money arrives on the 19th. This is not paid and is in the bank account on the 23rd when then liquidators arrive.

The trust applies to the $2,000 due for the wages paid on the 1st of the month, but not to the $10,000 outstanding.

A note of caution; This is just our view. It is possible, even probable, that the Commissioner would disagree with our interpretation of the Jennings decision. The Commissioner may consider that a trust extends over this new money. Hopefully the Supreme Court can give some clarity on this issue.