

EXPOSURE DRAFT – FOR DISCUSSION AND COMMENT ONLY

Deadline for comment: **11 February 2022**

Please quote reference: **ED0239**

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OPERATIONAL STATEMENT

Available Subscribed Capital record keeping requirements

Issued: DD MM XXXX

ED0239

Operational statements set out the Commissioner of Inland Revenue’s view of the law in respect of the matter discussed and deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement sets out the Commissioner’s approach to applying the statutory record keeping requirements that are necessary to substantiate distributions of Available Subscribed Capital (ASC).

All legislative references in this Statement are to the Income Tax Act 2007, unless specified otherwise.

This Statement applies from the date of issue.

START DATE

{DD/MM/XXXXa}

Introduction

This Statement sets out the Commissioner's approach to the record keeping requirements necessary to substantiate an amount returned to a shareholder tax-free as a distribution of ASC. For an amount to be distributed tax-free it will need to not be caught under the definition of a dividend.

What is a dividend?

1. A transfer of value from a company to a person will be a dividend (and therefore income to that person¹ if:
 - the cause of the transfer is a shareholding in the company;² and
 - none of the statutory exclusions apply.³
2. While the definition of a dividend is wide, it is subject to several statutory exclusions. These are set out in ss CD 22 – 37. Sections CD 22 *Returns of capital: off-market share cancellations* and CD 26 *Capital distributions on liquidation or emigration* cover exclusions involving ASC.

The purpose of ASC – Return of capital

3. The purpose of calculating the ASC of a company is to determine the amount of capital that shareholders have paid into the company when subscribing for shares. This amount can generally be returned to the shareholders free of tax when there is a repurchase of shares or the company is liquidated (under either ss CD 22 or CD 26), so comes within the statutory exclusion from the definition of dividend in s CD 4. The calculation rules for ASC are provided for in s CD 43 *Available subscribed capital (ASC) amount*.
4. However, the Commissioner has seen a number of cases where there are concerns around the company's calculation of ASC and the taxpayers have been unable to provide sufficient information when requested, as they have not retained sufficient records to substantiate their tax positions taken at the time that the distribution was made.

¹ Section CD 1.

² Section CD 4(1)(a).

³ Section CD 4(1)(b).

5. This leads to questions around the basis for the tax position that the distributions are tax-free. It is noted that this has often happened where there has been a period of time in excess of 7 years from when the amount of ASC increased (ASC uplift) to when the distribution occurs (purporting to utilise the ASC uplift) and the tax position is taken (i.e., that the distribution is a tax-free return of capital).

Operational approach

6. The Commissioner may, in cases involving ASC uplifts where the taxpayer has not been able to provide sufficient evidence to support their ASC calculation, dispute the taxpayer's tax position on the basis that the distribution is a dividend under s CD 4. This is consistent with the onus of proof in s 149A(2)(b) of the Tax Administration Act 1994 (the TAA) (see below).
7. The reasoning for this approach is as follows:
 - The taxpayer company has made a distribution to the shareholder (i.e., a transfer of value from the company to the shareholder).⁴
 - The cause of the transfer is the shareholding in the company.⁵
 - None of the exclusions from the definition of dividend apply.⁶

The onus of proof

8. The onus of proof is on the taxpayer to show that the basis for their self-assessment is correct (i.e., their tax position that the distribution is excluded from being a dividend because it is sheltered by ASC under either ss CD 22 or CD 26). A taxpayer needs to be able to provide sufficient evidence to support their position that they have enough ASC to shelter the distribution from being a dividend.
9. Section 22 *Keeping of business and other records* of the TAA lays out the record keeping requirements. Under s 22(2) taxpayers are required to keep sufficient records to allow the Commissioner to ascertain a taxpayer's tax position for a period of at least 7 years after the end of the income year to which they relate.
10. The formula for calculating ASC includes, amongst other elements, the 1 July 1994 balance and the consideration that the company received for the issue of shares after

⁴ Section CD 4(1).

⁵ Section CD 4(1)(a).

⁶ Sections CD 22 to 37.

30 June 1994 (i.e., the amount contributed by shareholders).⁷ Given this requirement, the ASC formula is clear that the calculation of ASC can require consideration of circumstances that happened more than 7 years ago (including, for example, the 1 July 1994 balance). A taxpayer taking a tax position based on the company's level of ASC would, consistent with the onus of proof, need to be able to substantiate the ASC calculation (and to be able to provide this information to the Commissioner - if requested). This is the case irrespective of whether the events feeding into that calculation may have happened more than 7 years ago.

11. Therefore, in line with the ASC calculation requirements and the statutory onus of proof being on the company, Inland Revenue would, in such cases, expect the company to keep sufficient records of their calculation of ASC, so that they are able to substantiate their tax position.
12. This operational approach is consistent with a number of other parts of the Act where a tax position may be taken based on (or taking into account) events or circumstances that may have happened more than 7 years ago and where taxpayers will need to keep sufficient records to substantiate their tax position.
13. This Operational Statement is based on the Commissioner's view of the law at the date of issue and applies until the statement is withdrawn, amended or any law change occurs.
14. This Statement was signed on DD MMMM 202X.

Rob Falk

National Advisor, Technical Standards, Legal Services

⁷ Section CD 43(2).