



**EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA  
- MŌ TE TĀKUPU ME TE MATAPAKI ANAKE**

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**OPERATIONAL STATEMENT | HE TAUĀKĪ WHAKAHAERE MAHI**

# **Returns of capital: Off-market share cancellations – bright line tests and the Commissioner’s notice requirements and other matters**

Issued | Tukuna: XX XXX 20XX

OS XX/XX

When amounts distributed on share cancellations are not within the s CD 22 exclusion from the dividend definition because the “in lieu of dividend” test applies is discussed in [IS 25/19](#): Income tax – Whether an off-market share cancellation is made in lieu of the payment of a dividend *Tax Information Bulletin* Vol 37, No 9 (October 2025).

This Operational Statement considers other aspects of s CD 22 and the factors to be considered when a company cancels shares and returns capital to its shareholders.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

# Contents

Introduction   Whakataki .....	2
Discussion   Matapaki .....	2
Dividends generally .....	2
Tests in s CD 22(2) .....	4
Bright line tests.....	4
Calculating the capital reduction amount.....	5
Requirement that the Commissioner has given a notice under s CD 22(8).....	6
When a notice under s CD 22(8) must be sought .....	7
How a company can request that the Commissioner issue a notice under s CD 22(8) ..	8
Records that should be supplied to the Commissioner to allow adequate consideration of s CD 22 .....	8
Timeframe for the Commissioner to respond to requests.....	9
Practical implications of a decision to issue a notice that the payment is not in lieu of a dividend .....	10
Practical implications of a decision not to issue a notice that the payment is not in lieu of a dividend .....	10
What the company can do if the Commissioner declines to issue a notice under s CD 22(8) .....	11
Breaching off-market share cancellation rules unintentionally or otherwise .....	11
References.....	13
Legislative references.....	13
Other references.....	13
About this document   Mō tēnei tuhinga .....	13

## Introduction | Whakataki

1. Section CD 22 provides a dividend exclusion for an amount a company pays to a shareholder because of an “off-market cancellation” of a share in a company that is not in liquidation.
2. [IS 25/19](#): Income tax – Whether an off-market share cancellation is made in lieu of the payment of a dividend<sup>1</sup> examines how the anti-avoidance rule in s CD 22(6) (the “in lieu of dividend” test) and the relevant factors in subs (7) apply to an amount a company pays a shareholder on an off-market cancellation of shares.
3. The focus of this statement is on the technical requirement in the bright line test for a share cancellation resulting in a capital reduction of 10% to 15% for the Commissioner to have given a notice under s CD 22(8) that no part of the payment on the share cancellation is in lieu of a dividend under subs (6).
4. This statement includes an outline of when and how to request a notice, what information to provide when requesting a notice, the practical implications when a notice is issued or the Commissioner declines to issue a notice, and the taxation consequences if any capital distribution is later found to be a dividend.
5. If any capital distribution is later found to be a dividend, this statement also notes the potential effect of the time bar, whether imputation credits can be attached and resident withholding tax (RWT) obligations.

## Discussion | Matapaki

### Dividends generally

6. Section CD 1 provides that a dividend derived by a person is income of the person. Section CD 3 states that ss CD 4 to CD 7, CD 7B, and CD 8 to CD 20 define what is a dividend.
7. Under s CD 4, a transfer of value from a company to a person is a dividend if the cause of the transfer is a shareholding in the company, as described in s CD 6, and none of the exclusions in ss CD 22, CD 23, CD 23B, CD 24 to CD 29, CD 29B, CD 29C, CD 30 to CD 34, CD 34B, CD 35, CD 36, CD 36B and CD 37 applies to the transfer (s CD 4(1)(b)).

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<sup>1</sup> IS 25/19: Income tax – Whether an off-market share cancellation is made in lieu of the payment of a dividend *Tax Information Bulletin* Vol 37, No 9 (October 2025): 9 (originally issued on 11 September 2025).

8. Section CD 6 describes when a transfer of value is caused by a shareholding relationship. A transfer of company value to a person is caused by a shareholding in the company if the recipient holds shares in the company or is associated with a shareholder and the company makes the transfer because of that shareholding.
9. Off-market share cancellations<sup>2</sup> result in a transfer of value by a company to a shareholder. Therefore, the transfer of value is a dividend unless expressly excluded from being a dividend by any of ss CD 22, CD 23, CD 23B, CD 24 to CD 29, CD 29B, CD 29C, CD 30 to CD 34, CD 34B, CD 35, CD 36, CD 36B and CD 37.
10. Section CD 22 applies when a company pays an amount to a shareholder for an off-market cancellation of a share in the company, other than on liquidation of the company.
11. Section CD 22(2) prescribes the tests that need to be satisfied for a payment on cancellation not to be a dividend. The subsection provides that to the extent the amount is equal to or less than the available subscribed capital (ASC) per share calculated under the ordering rule (in s CD 23) the amount is not a dividend if:
  - one of the bright line tests in s CD 22(3) is met;
  - the company is not an unlisted trust that has chosen the slice rule under subs (4); and
  - the anti-avoidance rule in subs (6) does not apply.
12. Section CD 23(1) provides for how to determine the ASC under the ordering rule:

available subscribed capital of class ÷ shares being cancelled of class

The ASC is defined in s YA 1 to mean the amount calculated for a share in a company under s CD 43. The ASC amount is:

1 July 1994 balance + subscriptions – returns – look-through company returns.
13. The ASC per share needs to be calculated so the company can determine whether the return of capital for the proposed share cancellation is less than or equal to the ASC per share.
14. This statement is concerned with the return of capital for off-market share cancellations for the amount that is equal to or less than the ASC calculated under the ordering rule. Any return of capital amount that is more than the ASC is not excluded

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<sup>2</sup> An off-market cancellation occurs when a company buys back its own shares directly from shareholders and not through a public exchange (for example, the NZX) and cancels the shares.

from being a dividend. (The excess is a dividend and the amount equal to or less than the ASC is then subject to the bright line and anti-avoidance rule.)

15. If the payment per share for the share cancellation does not meet the circumstances and tests prescribed in s CD 22(2), the entire payment must be treated as a dividend.

## Tests in s CD 22(2)

16. Section CD 22(2) specifies three tests to be satisfied before an amount can be excluded from being a dividend.

*Ordering rule*

...

- (2) **The amount is not a dividend** to the extent to which it is less than or equal to the available subscribed capital per share calculated under the ordering rule, **if—**
  - (a) **1 of the bright line tests in subsection (3) is met; and**
  - (b) the company is not an unlisted trust that has chosen the slice rule for the share under subsection (4); **and**
  - (c) **the anti-avoidance rule in subsection (6) does not apply.** [Emphasis added]

17. Both paras (a) and (c) are a minimum requirement for an amount to not be a dividend. The dividend exclusion applies only if one of the bright line tests (discussed below) is met and the anti-avoidance test does not apply. (For a discussion of the factors in s CD 22(7) applicable to the anti-avoidance test, see IS 25/19 at [32] to [71].)
18. If the company is an unlisted trust (para (b)) that has chosen the slice rule for the share under subs (4), s CD 22 cannot apply to it. An “unlisted trust” is defined in s CD 22(9). A company registered under the Companies Act 1993 is not an unlisted trust.

## Bright line tests

19. The structure of s CD 22 makes it clear that, subject to the anti-avoidance rule not applying, share cancellations of more than 15% meet a bright line test, so are not considered a dividend, and share cancellations of less than 10% do not meet a bright line test, so are considered a dividend.
20. The discussion in this statement relates to “pro rata” share cancellations between 10% to 15% to which the bright line test in s CD 22(3)(b) applies:

#### *Bright line tests*

- (3) The bright line tests referred to in subsection (2)(a) are as follows:
- (a) the cancellation is part of a pro rata cancellation that results in a fifteen percent capital reduction for the company:
  - (b) **the cancellation is part of a pro rata cancellation that results in a ten percent capital reduction for the company and the Commissioner has given a notice under subsection (8):**
  - (c) the cancellation is not part of a pro rata cancellation and results in the shareholder suffering a fifteen percent interest reduction:
  - (d) the company is an unlisted trust and the cancellation is not part of a pro rata cancellation:
  - (e) the share is a non-participating redeemable share. [Emphasis added]

21. A pro rata cancellation is defined in s YA 1 as the cancellation of all the shares in a class or some of the shares in a class if the cancellation does not alter any person's voting or market value interest, or some of the shares in the class if the cancellation, if each shareholder accepted the offer, would not alter a person's voting or market value interest in the company.
22. Section CD 22(3)(b) has two significant components:
- a 10% or more capital reduction; and
  - the Commissioner has given a notice under subs (8)

## **Calculating the capital reduction amount**

23. Capital reduction is defined in s CD 22(9) in relation to both the 10% and 15% reductions as:

the circumstance in which the total amount paid by the company on account of the cancellation, or paid on account of any other pro rata cancellation of participating shares in the company occurring at the same time, is at least [10% or 15%] of the market value of all participating shares in the company at the time the company first gave notice to shareholders of the cancellation.

24. The market value of the shares is calculated when the company first gave notice to the shareholders of the cancellation. The notice is anything the company provides that informs the shareholders of the planned share cancellation.

## Requirement that the Commissioner has given a notice under s CD 22(8)

25. For share cancellations of 10% to 15%, the relevant bright line test is in s CD 22(3)(b). The bright line test requires that the Commissioner has given a notice under subs (8) that the overriding anti-avoidance rule in subs (6) does not apply to the cancellation:

### *Commissioner notifying view*

- (8) If no part of a payment on cancellation of a share is in lieu of the payment of a dividend, the Commissioner may give notice to the company that subsection (6) does not apply to the cancellation.

26. Section CD 22(7) requires the Commissioner to consider the four factors listed in that subsection when determining whether the anti-avoidance rule in subs (6) applies and issue the notice if he is of the opinion the anti-avoidance rule does not apply.
27. The four factors are:
- the nature and amount of dividends paid by the company before or after the cancellation;
  - the issue of shares in the company after the cancellation;
  - the expressed purpose or purposes of the cancellation; and
  - any other relevant factor.
28. The analysis required for each of the four factors to determine whether a payment is in lieu of a dividend is set out in IS 25/19.
29. The practical implications for when notice is given and when notice is not given are discussed at [47] to [54].
30. It is share cancellations of only 10% to 15% that require the Commissioner's discretion to be exercised before cancellation. However, s CD 22(2)(c) prescribes that the anti-avoidance rule in subs (6) applies to **any** off-market share cancellations. Therefore, even if the return of capital for the share cancellation is more than 15% of the market value of participating shares, the cancellation must not breach the anti-avoidance rule.
31. As stated above, any capital reduction of less than 10% is not excluded from the definition of dividend, so is a taxable dividend.
32. For capital reductions of more than 15% there is no requirement in the legislation for the Commissioner to notify a view under s CD 22(8) that subs (6) does not apply. However, if a company wants more certainty that the Commissioner will not consider

the arrangement is an anti-avoidance arrangement, significant enterprises customers may request an indicative view.

33. Any company (including significant enterprises customers) may request a ruling or a short-process ruling (either of which is binding on the Commissioner) by following the guidance on the Inland Revenue website: [Apply for a ruling](#) or [Apply for a short-process ruling](#).

## **When a notice under s CD 22(8) must be sought**

34. Notice must be sought **before** the shares are cancelled.
35. Section CD 1 states that “a dividend derived by a person is income”. This means the time at which something is to be characterised as being a dividend is the time when it is derived. Timing of derivation does not always depend on there being a payment. However, s CD 22 “applies when a company pays an amount to a shareholder” (s CD 22(1)). For our purposes, a dividend can be generally said to be derived by the time an amount has been paid to a shareholder. This could be different from the time at which the shares were cancelled. Whether cancellation occurs contemporaneously with payment to the shareholder or at some other time, the important question is whether the relevant amount was or was not a dividend when it was paid. The time to characterise a payment as being excluded from being a dividend under s CD 22 is the time of payment.<sup>3</sup>
36. As discussed above, for share cancellations the amount to be returned to the shareholder is a dividend unless, to the extent of the ASC per share, one of the bright line tests in s CD 22(3) is met and the anti-avoidance rule does not apply. For share cancellations of 10% to 15% the bright line test (s CD 22(3)(b)) requires the Commissioner to have given notice under subs (8) that the anti-avoidance rule does not apply to the share cancellation.
37. Therefore, the Commissioner must have issued a notice before the payment reflecting the share cancellation is made. Without the required notice, on cancellation of the shares, the payment is not excluded from being a dividend under s CD 22 because a bright line test is not met.

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<sup>3</sup> Section CD 22(1) states, “This section applies when a company pays an amount to a shareholder because of the off-market cancellation of a share in a company, other than on liquidation of a company”.



38. Because a notice must be sought before the share cancellation, if the Commissioner declines to issue a notice, the company may choose not to continue with the share cancellation.
39. The records the company should supply when requesting a notice under s CD 22(8) are specified in [43].

## **How a company can request that the Commissioner issue a notice under s CD 22(8)**

40. The legislation does not specify the form of a request for a notice. However, to assist the Commissioner with meeting the legal requirement to consider the four factors in s CD 22(7), the request should be in writing and should include the information (records) outlined in [43].
41. A request for notice under s CD 22(8) can be made in writing through the company's myIR account or by emailing [email address to be set up]. Alternatively, the company may apply for a ruling or short-process ruling, on matters of law, and make the request for a notice under s CD 22(8) as part of the application for a ruling.
42. If the company requests a ruling or short-process ruling, the request should go through the normal channels: [Apply for a ruling](#) or [Apply for a short-process ruling](#).

## **Records that should be supplied to the Commissioner to allow adequate consideration of s CD 22**

43. The records that should be supplied to the Commissioner are anything that is relevant to whether the share cancellation is in lieu of a dividend. The records should allow the Commissioner to understand the proposed cancellation and understand why the cancellation is not in lieu of a dividend. The types of information the Commissioner typically needs to consider are listed below, but depending on the circumstances of the share cancellation, other records may be relevant. The Commissioner typically needs to consider:
  - confirmation that the company is legally entitled to undertake a share cancellation pursuant to its constitution;
  - the date the directors are intending for the company to cancel the shares and make a payment to shareholders;

- evidence that the payment will be less than or equal to the company's ASC, including records substantiating how the company's ASC has been calculated or arisen;
- the calculation of the capital reduction amount, including details of how the market value of the shares was determined<sup>4</sup> as at the date notice of the proposed cancellation was given to shareholders;
- an analysis of the factors to be considered in determining whether the payment is in lieu of a dividend (ie, the factors that must be considered as listed in s CD 22(7) and analysis of the factors as outlined in IS 25/19);
- detailed financial statements for the last 3 years;
- the company's dividend policy (if any) and details of dividends the company has paid for the preceding 3 years or other relevant period; and
- other documents that demonstrate the company's purpose of cancelling shares (see IS 25/19 at [45] and [46]).

## **Timeframe for the Commissioner to respond to requests**

44. The length of time it takes the Commissioner to respond he has received a request for notice and all supporting information, is highly dependent on the factors relating to the capital reduction and the work required for the Commissioner to be satisfied the capital reduction is not in lieu of a dividend.
45. The Commissioner will contact the company (or company's representative) and provide a time frame for his response. This is important so the company is aware it cannot continue with or complete the planned share cancellation without triggering unexpected tax consequences.
46. When the Commissioner is satisfied all necessary information has been provided, he will respond to the company with the notice or the decision to not issue the notice within 28 days.

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<sup>4</sup> The Commissioner is not required to validate this factor. If the valuation is materially incorrect, the notice, if given, is not valid (see [57] to [60]).

## **Practical implications of a decision to issue a notice that the payment is not in lieu of a dividend**

47. Before the Commissioner issues his notice under s CD 22(8), he determines, based on the information received and assessed against the four factors when considering the anti-avoidance rule in s CD 22(6), that the anti-avoidance rule does not apply.
48. When a company requests a notice and the Commissioner is satisfied that a share cancellation is not in lieu of a dividend, he will issue the notice.
49. When the Commissioner issues the notice, he provides certainty to the company that he has considered the arrangement and does not consider the share cancellation to be an avoidance arrangement (subject to the comments at [57] to [60]). The Commissioner will not generally change his position provided the company has not withheld any information that, if provided, would have caused the Commissioner to have a contrary view. However, the notice does not legally require the Commissioner to maintain the position in the notice. This is because in addition to the bright line being met (which requires a notice under s CD 22(8) for a share cancellation of 10% to 15%), the anti-avoidance rule must also be met. Although the Commissioner may be satisfied when he issues the notice under subs (8), if he has cause to, he can later take issue with the dividend exclusion applying whether information has been withheld or not.
50. The notice provides comfort only in the context of the share cancellation and the specific anti-avoidance rule in s CD 22(6). Any wider arrangement, and any potential for it to be a tax avoidance arrangement, is not addressed or considered as part of the notice issued under s CD 22(8).

## **Practical implications of a decision not to issue a notice that the payment is not in lieu of a dividend**

51. As outlined in [25], for share cancellations of 10% to 15% the bright line test includes a requirement that the Commissioner has given a notice under s CD 22(8) that no part of the share cancellation is in lieu of the payment of a dividend.
52. If, in the Commissioner's opinion, the payment on cancellation of the shares would be in lieu of a dividend, the Commissioner cannot issue a notice.
53. The Commissioner will advise the company about the decision to not issue a notice (that the decision is a disputable decision) and let the company know what it can do to challenge the Commissioner's decision (discussed below).

54. As the request for notice is required before the share cancellation, if no notice is received the company can discontinue or postpone the proposed share cancellation or continue in the knowledge the amount paid to shareholders on cancellation of the shares will be a dividend, so taxable to a shareholder.

### **What the company can do if the Commissioner declines to issue a notice under s CD 22(8)**

55. A decision to decline to issue a notice under s CD 22(8) is a decision of the Commissioner under a tax law. The decision to not issue a notice is made using the Commissioner's discretion and is based on his opinion that the share cancellation is in lieu of a dividend. It is, therefore, a "disputable decision" as defined in s 3 of the Tax Administration Act 1994 (TAA) unless there is no right of challenge. Section CD 22 is not listed in s 138E of the TAA as a section that does not confer a right of challenge. This means the company has a right to challenge the decision.<sup>5</sup>
56. A company wishing to dispute a disputable decision that is not an assessment, must issue a Notice of Proposed Adjustment within the applicable response period.<sup>6</sup> Section 89AB(4) of the TAA states the response period is 4 months from the date of issue of the initiating notice. In this case, the initiating notice is the letter the Commissioner issues to say he is not going to issue a notice under s CD 22(8).

### **Breaching off-market share cancellation rules unintentionally or otherwise**

57. In some situations, the company may have cancelled shares on the basis that cancellation is of more than 10% (and the Commissioner has given a notice) or more than 15% (no notice required) of the capital market value of the company, and after the cancellation of the shares and resulting payment, the company or the Commissioner identifies that part of a payment was in lieu of a dividend.
58. In this situation, if a notice had been given, it would, arguably, not be one authorised by s CD 22(8) because that subsection authorises the Commissioner only to give a notice if the payment is not in lieu of a dividend. The bright line test in s CD 22(8) would appear to be met because the Commissioner had given a notice before the

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<sup>5</sup> See Disputing an assessment: What to do if you dispute an assessment – IR776 (guide, Inland Revenue, December 2023).

<sup>6</sup> SPS 23/01: Disputes process *Tax Information Bulletin* Vol 35, No 3 (April 2023): 48 at [63] – [68] and [288] – [295].

share cancellation. However, it is unclear whether the Commissioner should be taken to have given the required notice if the pre-condition of that notice that the share cancellation was not in lieu of dividend has not been met.

59. In any event, s CD 22(2) requires that both a bright line test is met and the anti-avoidance rule in subs (6) does not apply. This means for any capital reduction, for an amount to be excluded from being a dividend, even if the Commissioner has given a notice that subs (6) does not apply, subs (6) must also not actually apply.
60. If after shares have been cancelled, it is identified that s CD 22(6) applies, the following will be the outcome for the income tax year the shares were cancelled in:
- The amount of the payment for the off-market share cancellation is “in lieu of a dividend”, so it is a dividend and income of the shareholder under s CD 1.
  - The assessments in the shareholders’ tax returns need to be amended to include dividend income.
  - No imputation credits can be retrospectively attached to the dividend payment (ss OB 60 and OB 62).
  - The company could file an RWT return in the relevant period or may be liable for RWT on the payment (s RE 13).
  - Section 99 of the TAA may be available for the Commissioner to make an assessment of RWT that the company is liable to pay.
  - The time bar rules in s 108 of the TAA apply only if a return has been filed and more than 4 years have passed from the end of period in which the return was filed, and that return disclosed a dividend payment made to the relevant shareholder from which RWT was withheld.

This statement was signed on XX XXX 20XX.

**[Insert name]**

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Inland Revenue | Te Tare Taake

# References

## Legislative references

Companies Act 1993

Income Tax Act 2007, ss CD 1, CD 3, CD 4 to CD 7, CD 7B, CD 8 to CD 20, CD 22, CD 23, CD 23B, CD 24 to CD 29, CD 29B, CD 29C, CD 30 to CD 34, CD 34B, CD 35, CD 36, CD 36B, CD 37, CD 43, OB 60, OB 62, RE 13, YA 1 ("available subscribed capital", "pro rata cancellation")

Tax Administration Act 1994, ss 3, 89AB, 99, 108, 138E

## Other references

Apply for a short-process ruling (webpage, Inland Revenue, last updated 1 April 2023)  
[ird.govt.nz/managing-my-tax/short-process-rulings/who-can-get-a-short-process-ruling/apply-for-a-short-process-ruling](https://ird.govt.nz/managing-my-tax/short-process-rulings/who-can-get-a-short-process-ruling/apply-for-a-short-process-ruling)

Apply for a ruling (webpage, Inland Revenue, no date)  
[taxtechnical.ird.govt.nz/apply-for/apply-for-a-ruling](https://taxtechnical.ird.govt.nz/apply-for/apply-for-a-ruling)

Disputing an assessment: What to do if you dispute an assessment – IR776 (guide, Inland Revenue, December 2023)  
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[taxtechnical.ird.govt.nz/standard-practice-statements/disputes/sps-23-01](https://taxtechnical.ird.govt.nz/standard-practice-statements/disputes/sps-23-01)

## About this document | Mō tēnei tuhinga

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.