

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Income tax – Overdrawn shareholder loan account balances

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IS 24/09

This interpretation statement considers common tax issues associated with overdrawn shareholder loan accounts held in New Zealand resident close companies.

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

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Summary | Whakarāpopoto

1. Shareholder loan accounts are generally informal arrangements between close companies and shareholders that keep track of any advances made between them. When a shareholder draws more money from the company than they have advanced to the company, their shareholder loan account becomes overdrawn.
2. An overdrawn shareholder loan account can give rise to a range of tax issues. Where non-market terms apply to the overdrawn balance such as a low or nil interest rate, the dividend or the fringe benefit tax (FBT) rules may tax the value or benefit received by the shareholder. However, in some instances, the Act permits a retrospective repayment of the amount owing on a shareholder loan account. This concessionary treatment provides more time for companies to calculate and allocate certain

shareholder remuneration or dividends towards repaying overdrawn shareholder loan accounts.

3. Alternatively, companies may enter into an agreement with their shareholders to charge interest on the amounts owed by the shareholders at the market rate or the Commissioner's prescribed interest rate, so no dividends or fringe benefits arise. However, this approach may lead to other tax consequences that companies and shareholders should be aware of.
4. Broadly, this statement discusses the following common tax issues associated with an overdrawn shareholder loan account:
 - Dividend income arises for a shareholder where they pay no or low interest on their overdrawn shareholder loan account.
 - FBT liabilities arise when a shareholder-employee pays no or low interest on their overdrawn shareholder loan account.
 - Interest income arises where a company charges interest on an overdrawn shareholder loan account. The timing and quantification of the interest income are generally determined under the financial arrangements (FA) rules, subject to certain concessionary rules for taxpayers who operate on a smaller scale.
 - Where resident withholding tax (RWT) has been withheld from interest payable to a company, the company may claim a tax credit for the RWT. The company may claim the credit in the year in which the interest is derived, provided the RWT has been withheld and paid to Inland Revenue.
 - Interest paid by a shareholder on their overdrawn shareholder loan account is generally not deductible to the shareholder. This is because drawings are often applied to fund a shareholder's private or domestic expenditure and therefore the corresponding interest has no nexus to income. However, it is possible that some shareholders may draw money to apply to an income-earning activity or a business. In such cases, they may claim a deduction to the extent the interest relates to the income-earning activity or business, subject to the general limitations. Shareholders should maintain sufficient documentation to support any such interest deduction claims.
 - In most cases, a shareholder paying interest on their overdrawn shareholder loan account is not required to withhold RWT from the interest. A withholding obligation may arise for a shareholder who has RWT-exempt status or pays interest in the course of carrying on a taxable activity. However, this is subject to a \$5,000 de minimis threshold. In addition, a shareholder does not need to withhold RWT on interest paid to a company that has RWT-exempt status.
 - Similarly, in most cases, a shareholder paying interest on their overdrawn shareholder loan account is not required to report information to Inland Revenue

under the investment income reporting rules. Reporting is only required for a shareholder who has an RWT withholding obligation or who has no RWT withholding obligations on interest but to whom all of the following apply:

- The interest is not subject to RWT because it is not paid in carrying on a taxable activity or is exempt under the \$5,000 de minimis rule.
 - The shareholder is allowed an income tax deduction for the interest.
 - The interest is paid to a person (ie, the company) who does not have RWT-exempt status.
- Where a shareholder is relieved of their obligation to repay their overdrawn shareholder loan account balance, income will arise under the dividend rules or under the FA rules. Generally, the amount forgiven or remitted is an amount of dividend income for the shareholder. Both the company and the shareholder are also required to calculate a base price adjustment (BPA). This calculation generally means that:
 - the shareholder is not taxed twice under both the dividend and the FA rules; and
 - the amount the company writes off does not produce a deductible negative BPA amount.

Introduction | Whakataki

5. Small businesses that are owned and operated by family members often trade through close companies. Due to the high degree of control a shareholder may exert over a close company, it is often easy for a shareholder to draw company funds for private purposes.
6. However, a close company is a separate legal entity from its shareholders. Funds of a close company are therefore the company's own property, and a shareholder's access to that property has tax implications including those under the:
 - dividend rules;
 - financial arrangements (FA) rules;
 - fringe benefit tax (FBT) rules;
 - resident withholding tax (RWT) rules; and
 - investment income reporting rules.
7. This statement provides general information on common tax issues relating to overdrawn shareholder loan accounts that are:

- owed to close companies that are resident in New Zealand under New Zealand tax law; and
 - **owed by** shareholders who are **natural persons** and **resident in New Zealand** under New Zealand tax law.¹
8. Comments in this statement may not apply to overdrawn shareholder loan accounts that are part of a tax avoidance arrangement.

Key terms

9. **Close company** means a company with five or fewer natural persons or trustees who hold more than 50% of the voting interests or market value interests in the company. All natural persons associated at the time are treated as one person.² Many New Zealand companies of various sizes could fall within the definition of a “close company”.
10. **FA rules** mean the rules in subpart EW that require parties to a financial arrangement to spread income or expenditure from the arrangement over its term. The key purpose of the FA rules is to prevent deductions for expenditure from being accelerated and income recognition from being deferred.
11. **Shareholder-employee** in this statement means a person who holds shares in a close company of which the person is also an employee. This does not necessarily align with the meaning of “shareholder-employee” as defined in s YA 1.
12. **Shareholder loan account** means a loan between a company and a shareholder. In the context of a close company, a shareholder loan account is often made informally and the relevant transactions are recorded in a “shareholder current account”.³

Analysis | Tātari

13. An overdrawn shareholder loan account balance arises when a shareholder draws or borrows money from a company and the total amount drawn exceeds the money the shareholder has loaned to the company. Essentially, the company is lending the amount of the overdrawn balance to the shareholder. Often, this occurs throughout the course of a year when a shareholder takes drawings from a company to fund their private expenditure (eg, living costs) in advance of receiving income from the company (eg, salary or dividends) (see [Example | Tauira 1](#)). In many cases, the income is

¹ Refer to **IS 16/03: Tax residence** for guidance on the residence rules for companies and natural persons under New Zealand tax law.

² See s YB 3 and meaning of “close company” in s YA 1.

³ See also *Case Q6* (1993) 15 NZTC 5,047.

calculated and credited to the shareholder loan account after the end of a financial year.

14. Notably, a company cannot claim an income tax deduction for drawings taken by its shareholders because the drawings are not an expense of the company. When a shareholder draws an amount from their shareholder loan account, the drawing represents either:
- a repayment of an earlier advance by the shareholder to the company; or
 - an advance by the company to the shareholder.

Example | Taura 1 – Overdrawing a shareholder loan account

On 1 April 2023, Nicola incorporates a company, Jungle Vibes Limited (JVL), to start an indoor plant retailing business. JVL is initially funded via nominal share capital of \$100 and an advance of \$10,000 from Nicola.

JVL does not require additional funds from Nicola and instead generates sufficient cashflow to allow Nicola to draw \$5,000 per quarter to pay for her personal rent and other living costs.

By 31 March 2024, Nicola’s shareholder loan account becomes overdrawn by \$5,000 as shown below:

Date	Transaction	Money (in) / out	Balance ⁴
01/04/2023	Opening balance	-	-
01/04/2023	Shareholder advance	(\$10,000)	(\$10,000)
01/07/2023	Drawings	\$5,000	(\$5,000)
01/10/2023	Drawings	\$5,000	-
01/01/2024	Drawings	\$5,000	\$5,000
31/03/2024	Closing balance	-	\$5,000

The issues

15. The main income tax issues that are relevant to an overdrawn shareholder loan account are:
- when an overdrawn shareholder loan account gives rise to a taxable dividend;

⁴ The Act allows the retrospective crediting of a shareholder loan account under certain circumstances that could reduce an overdrawn balance. This statement discusses those rules from [40] to [41] and from [54] to [57].

- the interaction between the dividend rules and the FBT rules for a shareholder-employee with an overdrawn account;
- where interest is charged on the loan:
 - how the company and the shareholder should account for the interest in their respective income tax returns;
 - whether there are any withholding tax obligations;
 - whether there are any investment income reporting obligations; and
- what happens when the shareholder is relieved from meeting the remaining obligations under the loan.

When an overdrawn shareholder loan account gives rise to a dividend

16. Broadly, the dividend rules in subpart CD seek to identify transactions that transfer monetary value from a company to a shareholder (or a person associated with the shareholder) and treat such transactions as “dividends” that are taxable to the benefiting shareholders. These rules are relevant to an overdrawn shareholder loan account because the overdrawn balance represents a use of company property (ie, company funds) by a shareholder. This could give rise to situations where company value is transferred to the shareholder.

What gives rise to a dividend?

17. Under the Act,⁵ a “dividend” is a transfer of company value from a company to a person if:
- the cause of the transfer is a shareholding in the company; and
 - none of the exclusions in subpart CD apply.
18. The concepts of “transfer of company value” and whether the transfer is caused by a shareholding are discussed in detail in **IS 21/05: Non-cash dividends** (see [14] to [25]) and are not repeated in this statement. In summary, a “transfer of company value”:
- arises under an arrangement where a company provides money or money’s worth to a person that exceeds the market value of what the person provides to the company in return;⁶ and

⁵ Section CD 4.

⁶ Section CD 5(1).

- is caused by a shareholding where the recipient is a shareholder in the company (or is associated with a shareholder in the company) and the company makes the transfer because of that shareholding.⁷

Transfer of company value

19. The term “money or money’s worth” requires that a benefit be in money or be convertible into money, either directly or indirectly.⁸ For an overdrawn shareholder loan account, the shareholder’s use of company funds is “money or money’s worth” provided to the shareholder. A “transfer of company value” will therefore arise where the shareholder does not provide adequate “market value” for the use of the company funds.
20. In the context of a loan, the ordinary meaning of “market value” applies.⁹ Generally, the market value of something is the price that would be agreed between a willing but not anxious seller and a willing but not anxious buyer. It is determined objectively.¹⁰
21. The Commissioner considers the “market value” that a borrower provides for a loan like an overdrawn shareholder loan account would generally be interest payments, on top of the principal repayments. A rational lender would generally expect to be compensated for their time value of money, lending risks and other factors. The compensation is generally achieved by charging a market interest rate on the loan.
22. Therefore, if a company charges interest on an overdrawn shareholder loan account at a rate that is below the relevant market interest rate (or does not charge interest at all, see Example | Taurira 2), the shareholder has not provided adequate “market value” in return. This situation results in a “transfer of company value” to the shareholder.

Example | Taurira 2 – Transfer of company value

Following on from Example | Taurira 1, JVL provides Nicola with her overdrawn shareholder loan account on an interest-free basis.

This benefit is a “transfer of company value” because the value of the amounts advanced by JVL is worth more than the value of Nicola’s repayments in the future. This is due to the time value of money and Nicola not paying interest to

⁷ Section CD 6(1).

⁸ *Tennant v Smith* (1892) 3 TC 158 (HL), *Stagg v CIR* [1959] NZLR 1,252 (HC), *Abbott v Philbin (Inspector of Taxes)* [1960] 2 All ER 763 (HL), *Heaton (Inspector of Taxes) v Bell* [1969] 2 All ER 70 (HL) and *Dawson v CIR* (1978) 3 NZTC 61,252 (SC).

⁹ Section YA 1 defines “market value” only in a number of circumstances, none of which are relevant here.

¹⁰ *Hatrick v CIR* [1963] NZLR 641 (CA) at 661.

make up for the difference in the market value between what JVL provides to Nicola and what Nicola provides (in the future) to JVL.

23. Determining the relevant market interest rate can be challenging because there is unlikely to be a “market” for overdrawn shareholder loan accounts. It is therefore difficult to find comparable arrangements and interest rates. However, the prescribed calculation method for a dividend offers a practical solution.
24. Generally, the dividend amount for an overdrawn shareholder loan account is the excess of interest calculated using the prescribed rate over the actual interest charged.¹¹ As long as the actual interest rate charged on an overdrawn shareholder loan account is at least equal to Inland Revenue’s prescribed rate of interest (discussed in more detail at [36] to [39]), the amount of the dividend will be nil. This result holds even if the relevant market interest rate is higher than the prescribed rate.
25. Where a taxpayer considers the market interest rate applicable to their overdrawn shareholder loan account is lower than the prescribed rate, the taxpayer should document evidence to support their position. The relevant evidence may include:
 - the terms of the loan (eg, interest rate, loan duration, repayment terms, etc),
 - any collateral, and
 - contemporaneous pricing of any comparable arrangements with similar terms (eg, personal loans with similar terms).
26. Separate to the above discussion around interest rates, a company also provides “money or money’s worth” to a person where it releases the person from repaying a debt owed to it, either by agreement or by the operation of law.¹² This means a “transfer of company value” arises if a company releases a shareholder from repaying a debt.

Caused by a shareholding

27. As to whether a “transfer of company value” is caused by a shareholding, which is another test for determining whether an amount is a dividend (as noted at [17] and [18]), the relevant considerations are the following:

¹¹ Note, if the shareholder loan account is in a currency that is not the New Zealand Dollar, the relevant rate would not be the prescribed rate of interest. Instead the relevant rate would be the Commissioner’s benchmark rate for that currency (if any).

¹² Section CD 5(2). For completeness, a transfer of company value may not arise where the lender and the borrower are members of the same wholly owned group of companies; see s CD 5(2)(a) and (b) but such a situation is outside the scope of this statement.

- Whether the “transfer of company value” is received by a shareholder.¹³
 - Whether the “transfer of company value” is caused by the shareholding of the relevant shareholder.
28. It is clear that benefits associated with an overdrawn shareholder loan account are received by a shareholder. The focus is therefore on whether the company makes the transfer of value because of that shareholding.
29. One indication that a transfer is caused by a shareholding is where the terms of the arrangement that results in the transfer are different from the terms on which the company would enter into a similar arrangement if no shareholding were involved.¹⁴
30. As noted at [20] and [21], in a commercial setting, it is generally expected that a loan between unrelated arm’s length persons would be repaid in full and that the lender is fairly compensated for the borrower’s use of the lender’s money. Therefore, the Commissioner considers the benefit is caused by the shareholder’s shareholding if any of the following benefits is provided under an overdrawn shareholder loan account:
- The loan is provided on an interest-free basis (see Example | Taura 3).
 - The interest charged on the loan is below the prevailing market interest rate for a loan issued on similar terms.
 - The shareholder does not need to repay their loan account.
31. It is possible that, in certain cases, some or all of the above benefits are provided to unrelated borrowers as well as a shareholder, such that the benefits (ie, the transfer of value) are not caused by a shareholding. In such cases, the company will need to be able to demonstrate that it would provide lending to unrelated parties with terms and benefits similar to the shareholder loan account.

Example | Taura 3 – Transfer caused by shareholding

Following on from Example | Taura 2, Nicola’s interest-free overdrawn shareholder loan account is caused by her shareholding in JVL. This is because JVL is in the business of retailing indoor plants and would not provide a loan to unrelated parties on an interest-free and on-call basis.

32. In summary, a dividend arises in respect of an overdrawn shareholder loan account when the loan leads to a transfer of company value to the shareholder that is caused by the shareholder’s shareholding. The most common attributes that lead to a

¹³ Under s CD 6(1)(a)(ii), a transfer of company value can also arise if the recipient is associated with the shareholder. However, as this item discusses overdrawn shareholder loan accounts, it is aimed at loans lent directly to shareholders as opposed to associates of shareholders.

¹⁴ Section CD 6(2), *Case V9* (2001) 20 NZTC, 10,101 (TRA) and *Campbell v CIR* [1968] NZLR 1 (HC).

dividend in this context are charging a low interest rate or no interest on the loan and the forgiveness of the loan¹⁵. Therefore, in certain situations, multiple dividends could arise from an overdrawn shareholder loan account. For example, where a company does not charge interest on an overdrawn shareholder loan account and then, at a later date, forgives the overdrawn balance, dividends would arise from both the interest forgone (assessed quarterly, see [35]) and the amount of the debt forgiven (see [93]).

33. Although specific dividend exclusions set out in subpart CD exclude certain transactions from the meaning of "dividend", most of those exclusions do not apply to benefits provided under an overdrawn shareholder loan account. The exception is that a fringe benefit provided to a shareholder-employee that is subject to FBT is treated as not being a dividend.¹⁶ Benefits provided to a shareholder-employee are discussed from [44].
34. The above is consistent with IS 21/05, which explains that an interest-free or low-interest overdrawn shareholder loan account gives rise to a non-cash dividend (see [38] to [42] and Example 22 of IS 21/05).

Dividend calculation for interest-free or low-interest loans

35. The amount of a dividend from an overdrawn shareholder loan account is calculated for each quarter during which the account is overdrawn. The dividend is treated as being paid 6 months after the end of the company's income year, unless the company gives the shareholder earlier notice of the amount of the dividend.¹⁷
36. There are two ways to calculate the amount of the dividend at the company's option.¹⁸ The amount is the difference between either:
 - the benchmark interest and the actual amount of interest accruing on the loan; or
 - the benchmark interest and the amount of income accruing to the company in the quarter calculated under the yield to maturity method.
37. The benchmark interest¹⁹ is the interest calculated for the quarter on the daily balance of the loan calculated using:

¹⁵ Loan forgiveness is discussed later from [92].

¹⁶ Section CD 32(1)(a).

¹⁷ Section CD 39(2) and (3).

¹⁸ Section CD 39(5).

¹⁹ Section CD 39(6) to (8).

- where all amounts are expressed in **New Zealand dollars** and the borrower is not a company, the “**prescribed rate of interest**” declared by regulations (see Example | Tauria 4); or²⁰
 - where all amounts are expressed in a single **currency other than New Zealand dollars** and the borrower is not a company, the **benchmark rate** the Commissioner **set for that currency** (if any).²¹
38. In all other cases, the benchmark interest can be calculated using a market rate determined at the end of the quarter for a loan made on the same terms between persons at arm’s length. However, this market rate method is generally not available for an overdrawn shareholder loan account of a natural person shareholder in New Zealand. The market rate method is only available if the “prescribed rate of interest” or the Commissioner’s benchmark rate for a foreign currency do not apply. As stated at [37], where the borrower (ie, the shareholder) is not a company and the loan is in New Zealand dollars, the benchmark rate of interest is the “prescribed rate of interest”.
39. Therefore, the “prescribed rate of interest” is likely the most relevant rate for a close company resident in New Zealand. The rate is set from time to time by the Governor-General²² and is available from [Prescribed interest rates for fringe benefit tax \(FBT\)](#) on the Inland Revenue website.

Example | Tauria 4 – Calculating a dividend using the prescribed rate of interest

Following on from Example | Tauria 3, and assuming Nicola is not an employee of JVL, she is deemed to have received a dividend equal to the difference between the benchmark interest and the actual amount of interest accruing on the loan.

As the loan is in New Zealand dollars and the borrower (Nicola) is not a company, the prescribed interest rate is the benchmark interest rate used to calculate Nicola’s dividend.

Nicola’s loan account becomes overdrawn on 1 January 2024 and therefore the applicable prescribed interest rate is 8.41%.

²⁰ For completeness, the “prescribed rate of interest” can also be used when the borrower is a company if an election to use that rate is made and the Commissioner is notified of the election in accordance with s CD 39(12).

²¹ If the borrower is another company, the benchmark rate is the rate set by the Commissioner if the company making the loan has notified the Commissioner in accordance with s CD 39(12) that the Commissioner’s rate is to apply.

²² Section YA 1 – meaning of “prescribed rate of interest” – and s RA 21(3).

For the quarter 1 January 2024 to 31 March 2024, the amount of the dividend is calculated as follows:

$$\text{Dividend} = \text{outstanding loan} \times \text{prescribed rate} \times \frac{\text{days in quarter}}{365}$$

$$\text{Dividend} = \$5,000 \times 8.41\% \times \frac{91}{365}$$

$$\text{Dividend} = \$104.84$$

40. For the purpose of calculating a dividend, a repayment made during the tax year may retrospectively reduce the overdrawn balance of a shareholder loan account.²³ This applies if all of the following requirements are met:
- the amount is repaid using salary, wages, extra pay, dividends or interest payable by the company to the shareholder;
 - the amount payable by the company is income of the shareholder in the tax year or an earlier tax year; and
 - the amount payable by the company is payable without any amount of tax being withheld under the PAYE, RWT or non-resident withholding tax (NRWT) rules, or is a fully imputed dividend.
41. Where the requirements at [40] are met, the repayment is applied retrospectively to the **later** of:
- the day the loan was made (eg, when the shareholder loan account became overdrawn, see Example | Taura 5); or
 - the start of the company's tax year (see Example | Taura 6).

Example | Taura 5 – Retrospective crediting of shareholder loan account

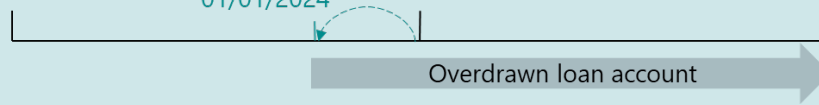
This example follows on from Example | Taura 4.

On 31 March 2024, JVL declares and pays a fully imputed dividend of \$2,985.07 (consisting of \$835.82 imputation credits, \$149.25 RWT and \$2,000 cash dividend). Nicola directs JVL to apply the cash dividend in repaying her overdrawn shareholder loan account.

The \$2,000 can be applied retrospectively to 1 January 2024 when the account first became overdrawn, as shown below:

²³ Section CD 39(9).

01/04/2023 01/01/2024 01/04/2024 01/04/2025



For the purpose of calculating Nicola’s deemed dividend from the overdrawn shareholder loan account balance, the following transactions will be taken into account:

Date	Transaction	Money (in) / out	Balance
01/04/2023	Opening balance	-	-
01/04/2023	Shareholder advance	(\$10,000)	(\$10,000)
01/07/2023	Drawings	\$5,000	(\$5,000)
01/10/2023	Drawings	\$5,000	-
01/01/2024	Drawings	\$5,000	\$5,000
01/01/2024	Dividend	(\$2,000)	\$3,000
31/03/2024	Closing balance	-	\$3,000

The calculation of Nicola’s dividend from the interest-free overdrawn shareholder loan account for the quarter ending 31 March 2024 would then be as follows:

$$Dividend = \text{outstanding loan} \times \text{prescribed rate} \times \frac{\text{days in quarter}}{365}$$

$$Dividend = \$3,000 \times 8.41\% \times \frac{91}{365}$$

$$Dividend = \$62.90$$

The calculations reflect the reduction of Nicola’s outstanding loan from \$5,000 (as shown in Example | Taura 4) to \$3,000 due to the retrospective crediting of the \$2,000 cash dividend effective 1 January 2024.

Example | Taura 6 – Resolving to pay a fully imputed dividend before year end but not quantifying the dividend amount until after year end

Vivien is a shareholder of Automate That Process Limited (ATP). Her interest-free shareholder loan account becomes overdrawn on 1 April 2023.

On 31 March 2024, the directors of ATP resolve to pay a dividend, with the exact amount to be confirmed once ATP finalises its accounts for the year ending 31 March 2024.

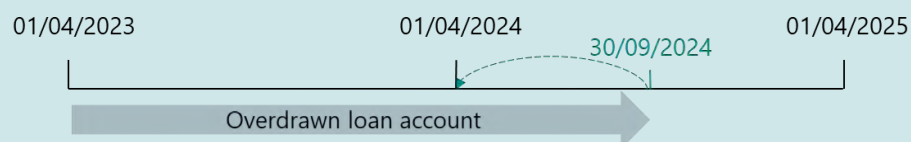
On 30 September 2024, ATP finalises its accounts and confirms the dividend amount. The dividend, which is fully imputed, is less than the amount owed by Vivien on her overdrawn shareholder loan account.

Vivien treats the dividend as income in the 2025 income year (under s CD 1(2)). She agrees with ATP to use the dividend to repay her overdrawn loan account. Consequently, ATP makes a journal entry on 30 September 2024 to credit the dividend to Vivien's shareholder loan account. This is the date ATP pays the dividend, not 31 March 2024 (when the dividend is first declared), because an amount cannot be considered "paid" if it is not quantified until later.

However, for the purpose of calculating the non-cash dividend arising from the overdrawn loan account balance, the backdating rule in s CD 39(9) applies. Under this rule, the dividend "paid" on 30 September 2024 can be retrospectively credited to Vivien's loan account on the **later** of:

- the date the loan was made (ie, when Vivien's loan account became overdrawn), being 1 April 2023; or
- the start of ATP's tax year, being 1 April 2024.

As 1 April 2024 is the later date, this is the date the dividend can be credited back to.



42. IS 21/05 addresses several other issues that are relevant when considering the dividend rules, as follows:

- rules around attaching imputation credits – see [43] to [46];
- dividend reversal when a debt is later repaid – see [47] and [48]; and
- the non-deductibility of dividends for the paying company – see [49].

43. Companies should also consider their withholding tax (eg, RWT) obligations for any dividends arising from overdrawn shareholder loan accounts.

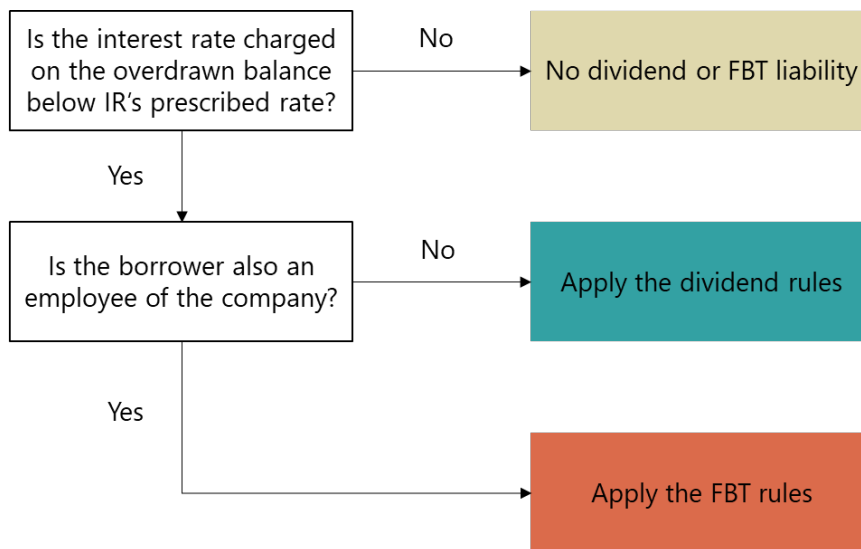
Overdrawn shareholder loan accounts for shareholder-employees

44. The dividend rules described from [16] do not apply to an overdrawn shareholder loan account for a shareholder-employee where the benefit is an interest-free or low-

interest loan. Instead, the FBT regime applies, and the company needs to pay FBT on the benefit.

45. A “shareholder-employee” in this context simply refers to an employee who holds shares in the company. In the context of a close company, shareholder-employees are often the working owners of the company.
46. Figure | Hoahoa 1 steps through the process of determining whether the dividend or the FBT rules apply to benefits provided in the form of an interest-free or low-interest loan.

Figure | Hoahoa 1: Application of tax rules on interest-free or low-interest overdrawn shareholder loan account²⁴



Meaning of “fringe benefit”

47. A “fringe benefit” is a benefit that an employer provides to an employee in connection with their employment.²⁵ It is either:²⁶
 - a classified benefit under ss CX 6, CX 9, CX 10, or CX 12 to CX 16; or
 - an unclassified benefit.
48. An overdrawn shareholder loan account is a classified benefit under s CX 10, which relates to employment-related loans. Under that section, a fringe benefit arises when

²⁴ Figure | Hoahoa 1 applies only to loan accounts denominated in New Zealand Dollars. As noted at [37], where the loan account is expressed in a single foreign currency, the applicable benchmark interest is calculated using the benchmark rate that the Commissioner has set for that currency, if any.

²⁵ For completeness, a fringe benefit can also arise when the benefit is provided to an associate of an employee, see ss GB 32 and CX 18.

²⁶ Section CX 2(1).

an employer provides a loan to an employee in a tax year in which the loan is owing. A fringe benefit does not arise for a loan made:

- as an employee share loan;
- under an exempt employee share scheme;
- as an overpayment of PAYE; or
- as an advance of salary and wages of up to \$2,000 in certain circumstances.

49. In most cases, an overdrawn shareholder loan account would not be any of the excluded loans at [48] and should therefore give rise to a “fringe benefit” subject to FBT for the shareholder-employee.
50. For a non-cash benefit such as an overdrawn shareholder loan account of a shareholder-employee, the FBT rules treat the benefit as being provided in connection with the shareholder’s employment.²⁷ Therefore it is not necessary to consider whether the benefit is more connected to the person’s shareholding or to their employment.
51. Although a specific rule²⁸ allows a company to choose whether to apply the dividend or FBT rules to a benefit provided to a shareholder-employee, that discretion applies only to “unclassified benefits”.²⁹ An employment-related loan, such as an overdrawn shareholder loan account, is not an “unclassified benefit” as it is classified as a fringe benefit specifically in s CX 10. **This means a benefit provided in the form of a low-interest or interest-free loan to a shareholder-employee is taxable under the FBT rules and not the dividend rules** (see Example | Taura 7).

Example | Taura 7 – Dividend or fringe benefit

Brock is a shareholder-employee of Onyx Club Limited (OCL), which operates a gym business. Instead of being paid a set regular salary, Brock is allowed to take reasonable monthly drawings from OCL and, as a result, his shareholder loan account is overdrawn during the course of the year. At the end of the financial year, OCL’s accountant calculates Brock’s annual salary, which is credited to his shareholder loan account and offset against his drawings.

OCL does not charge interest on the overdrawn shareholder loan account.

²⁷ Section CX 17(1).

²⁸ Section CX 17(2).

²⁹ Section CX 17(4)(b) and the meaning of “unclassified benefit” in ss YA 1 and CX 37.

Brock's interest-free loan is an "employment-related loan", which is deemed to be provided in connection with his employment with OCL. This gives rise to a "fringe benefit" for Brock and the FBT rules (instead of the dividend rules) apply.

FBT calculation

52. In most cases, the value of a fringe benefit arising from an overdrawn shareholder loan account for a period is either:³⁰
- the difference between the interest calculated on the daily balance of the employment-related loan using the prescribed interest rate (see [39]) and the actual interest accrued on the loan (see Example | Taura 8); or
 - the difference between the interest calculated on the daily balance of the loan using the prescribed interest rate and the income that would have accrued to the employer's benefit under the yield to maturity spreading method in the FA rules.
53. Employers who are in the business of lending money or are in a group of companies with a member that is in such business may choose not to apply the prescribed interest rate. Instead, these employers may use "market interest"³¹ to calculate the value of fringe benefits provided.³²
54. Similar to the dividends rules, a retrospective crediting of shareholder income to an overdrawn shareholder loan account is possible for FBT purposes. This applies to an amount that:
- is salary or wages, an extra pay, a dividend or interest; and
 - is payable by the employer without any tax being withheld and paid under the PAYE, RWT or NRWT rules, or is a fully imputed dividend; and
 - is income of the shareholder-employee in the tax year in which it is applied to repay the loan, or in an earlier income year.
55. Where a shareholder-employee is allocated income that meets the requirements at [54], that income can be treated as having been retrospectively credited to the overdrawn shareholder loan account. The retrospective credit arises either on the first day of that income year or on the day the balance of the loan account first became overdrawn during that income year, whichever is later.³³

³⁰ Section RD 34.

³¹ Specific requirements apply to demonstrate an amount is "market interest"; see s RD 35(5).

³² Section RD 35(1) and (2).

³³ Section RD 36(1) and (2).

56. A shareholder-employee may also elect to treat income as having been derived in an earlier year for the purpose of retrospectively crediting their overdrawn shareholder loan account. That is, where a shareholder-employee is allocated income by the company after the end of a particular year, the person may nevertheless elect to apply that income to the earlier year, provided that the requirements listed at [54] are met and the Commissioner is notified of this treatment.³⁴ The effects of the election are that:
- the income is treated as having been derived by the shareholder in the earlier year; and
 - the income is credited retrospectively to the overdrawn shareholder loan account in the earlier year (see Example | Taura 9).
57. The notification must be made within the time for filing the employer's return of income for the earlier year in which the employment-related loan is owed, although the Commissioner has a discretion to allow further time to lodge the notice.
58. Some companies have the option of filing annual or income year FBT returns while others need to file quarterly returns.³⁵ If the company files income year returns, it will have to work out the interest on the loan account and pay any FBT by the applicable due date. However, if the company has already filed quarterly returns, it must work out the correct interest and FBT payable on the loan account for each quarter in the year. The company may have to amend filed returns. Late payment penalties, interest or shortfall penalties may be imposed on any extra FBT owing. However, the ability to retrospectively credit the overdrawn shareholder loan account should reduce the earlier FBT assessments in most cases, rather than causing extra FBT to arise.

Example | Taura 8 – Taxable value of fringe benefit

Following on from Example | Taura 7, OCL wishes to calculate the value of the fringe benefit of Brock's overdrawn shareholder loan account for the 30 June 2023 quarter. Brock's loan account balance for the quarter is as follows:

Date	Transaction	Money (in) / out	Balance
01/04/2023	Opening balance	-	-
01/04/2023	Drawings	\$2,000	\$2,000
01/05/2023	Drawings	\$2,000	\$4,000
01/06/2023	Drawings	\$2,000	\$6,000
30/06/2023	Closing balance	-	\$6,000

³⁴ Section RD 36(3) and (4).

³⁵ See **Fringe benefit tax guide – IR409**, page 6.

The prescribed interest rate between 1 April 2023 and 30 June 2023 is 7.89%. Interest calculated using the prescribed interest rate for the quarter is as follows:

$$\text{April interest} = \$2,000 \times 7.89\% \times \frac{30}{365} = \$12.97$$

$$\text{May interest} = \$4,000 \times 7.89\% \times \frac{31}{365} = \$26.80$$

$$\text{June interest} = \$6,000 \times 7.89\% \times \frac{30}{365} = \$38.91$$

The value of the fringe benefit on Brock's loan account for the quarter is \$78.68 (\$12.97 + \$26.80 + \$38.91). The loan is provided on an interest-free basis and therefore the difference between the prescribed interest and the actual interest accrued equals the whole amount of the prescribed interest. FBT is payable on this amount.

Example | Taura 9 – Retrospective crediting of overdrawn shareholder loan account

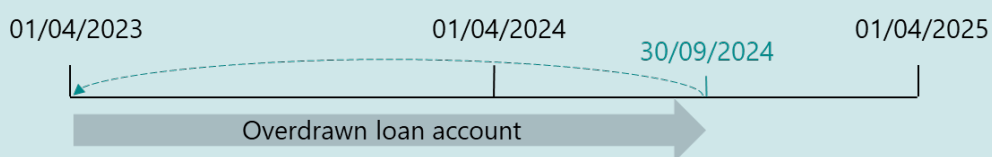
Maggie is a shareholder-employee of Simply Magginificent Limited (SML).

On 1 April 2023, Maggie draws money from SML to buy a new electric vehicle for her own use. As a result, her interest-free shareholder loan account with SML becomes overdrawn by \$50,000 on the same day.

On 30 September 2024, SML finalises its accounts for the 31 March 2024 year and resolves to pay a shareholder salary of \$50,000 to Maggie. The salary is also credited to Maggie's shareholder loan account on 30 September 2024.

Maggie elects to treat the salary as having been derived in the year ending 31 March 2024 in order to clear her overdrawn shareholder loan account in the earlier year.

For the purpose of calculating the fringe benefit arising from the loan, the salary can be treated as having been retrospectively credited to Maggie's loan account on 1 April 2023.



59. Example | Taura 9 seeks to demonstrate the backdating rule under ss RD 36(3) and (4) only. In practice, there will be return filing implications to consider. As noted at [58],

some companies file quarterly FBT returns and may have to amend previously filed returns to account for a backdated credit. However, many close companies with shareholder-employees have the option to file FBT returns on an income year basis if they meet the requirements in s RD 60. This option allows these companies to file their FBT returns for the entire income year and to return the FBT by the terminal tax due date for income tax. Therefore, these companies are able to calculate the remuneration to allocate to a shareholder-employee, the amount of a backdated credit and the associated FBT liability for the year at the same time (and after year end), without having to amend prior FBT assessments.

60. For more information on FBT generally or how to return FBT on an overdrawn shareholder loan account, refer to the **Fringe benefit tax guide – [IR409](#)**.

Charging interest on an overdrawn shareholder loan account

61. To relieve or eliminate both the dividend and FBT liability, some close companies and shareholders or shareholder-employees agree in advance that interest will be charged on any overdrawn shareholder loan account balance. Generally, they agree that interest will be charged at the prescribed rate. In this case, the value of the dividend or fringe benefit is reduced by the interest accrued on the loan as noted at [36] and [52]. This means that no dividend arises or that no FBT is payable. However, charging and paying interest has other tax consequences. These include that:
- the shareholder has an interest expense (which raises issues around deductibility, withholding tax obligations and investment income reporting obligations); and
 - the company has interest income (and maybe a tax credit if withholding tax obligations have arisen for the shareholder).

Interest expense for shareholder

Interest deductibility

62. Money drawn from a shareholder loan account is often used to fund the shareholder's private or domestic expenditure. In such cases, any interest the shareholder incurs on the overdrawn shareholder loan account will not be deductible because the interest would not be incurred in carrying on an income-earning activity or a business of the shareholder (see Example | Tauria 10).³⁶
63. It is conceivable that in some cases, a shareholder may draw money from a shareholder loan account for use in an income-earning activity or a business that they carry on separately. Where such drawings cause a shareholder loan account to become

³⁶ Sections DA 1, DA 2(1) and (2) and DB 6.

overdrawn and interest is charged on this debt, the interest may be deductible in the shareholder's personal tax return, provided that:

- the shareholder applies the amount borrowed from the company:
 - in deriving assessable or excluded income (or a combination of both), or
 - in the course of carrying on a business for the purpose of deriving assessable income or excluded income (or a combination of both); and
- the general limitations (other than the capital limitation³⁷) in s DA 2 do not apply.

64. By its nature, a shareholder loan account may often involve a constant inflow and outflow of funds that are applied to different uses (including the funding of non-deductible private or domestic expenditure). For this reason, it is important to maintain sufficient records to support any deduction claimed in a shareholder's tax return for interest on an overdrawn shareholder loan account.

Example | Taurira 10 – Private expenditure

Jin is a shareholder-employee of Jin's Video Editing Services Limited (JVES).

Jin holds a shareholder loan account with JVES. The shareholder loan account is for Jin to draw money to fund his personal living costs.

JVES has agreed with Jin in advance that, to the extent Jin's shareholder loan account is still overdrawn at year end, after crediting the account with his shareholder salary, interest will accrue at the applicable prescribed rate so that the company will not need to file FBT returns for the loan account.

For the year ending 31 March 2024, Jin has taken more in drawings than the salary allocated to him. The accountant calculates that interest of \$88 is payable on the overdrawn balance to 31 March 2024. Jin cannot claim this \$88 interest expense as a deduction in his income tax return because it is a cost of funding his private expenses.

65. Further, where funds are drawn and applied simultaneously for both income-earning and private purposes, apportionment is required and any interest deduction available is disallowed to the extent of the private use.³⁸
66. If a shareholder is entitled to deduct interest incurred on their shareholder loan accounts, they will have to allocate the interest deduction to an income year. This

³⁷ Section DB 6 overrides the capital limitation in s DA 2(1).

³⁸ See **IS 23/10: Deductibility of holding costs for land** (from [101] to [111]) for more detailed commentary on the requirement to apportion costs (in particular, interest) between income-earning use and private use.

depends on whether the shareholder returns their income on an accrual basis or cash basis.³⁹ If the FA rules apply (subject to the concessionary rules discussed from [67]), those rules will determine the income year to which the deductions are allocated.

Concessionary rules

Variable principal debt instruments

67. A person may be excluded from the requirement to apply the FA rules to an overdrawn shareholder loan account where:
- the loan account is a variable principal debt instrument (VPDI); and
 - the total value of all the person's VPDI's does not exceed \$50,000 at any point in the year.⁴⁰
68. A VPDI is a financial arrangement that contemplates that a party may advance further amounts to the other party on demand or on call.⁴¹ Examples of a VPDI are:
- a shareholder loan account;
 - a revolving credit facility where the borrower can borrow or repay principal at any time;
 - a credit card account; and
 - an everyday banking cheque account.
69. Because the threshold for the VPDI is relatively low and includes the value of all the VPDI's that a person is party to at any point in a year, it is expected that few taxpayers will be eligible to rely on this exclusion.

Cash basis persons

70. Where a person meets certain requirements, they may be a "cash basis person"⁴² for the purposes of the FA rules. This treatment allows them to account for an amount of financial arrangements income or expenditure (eg, interest) when it is received or paid.⁴³

³⁹ Section BD 4(3).

⁴⁰ Section EW 5(25).

⁴¹ Section YA 1 – para (a)(i) of the meaning of "variable principal debt instrument".

⁴² **IS 22/05: Cash basis persons under the financial arrangements rules** explains in detail when a person or entity may be a cash basis person as well as the implications of being a cash basis person.

⁴³ The Commissioner may treat a cash basis person as not being a cash basis person for a class of financial arrangements if there has been structuring and promotion of the class to defer a tax liability. This also may apply where the parties to a financial arrangement are associated and calculate different amounts of income and expenditure: s EW 59.

Withholding obligations

71. In most cases, a shareholder who pays interest on an overdrawn shareholder loan account should not have an obligation to withhold RWT from that interest. Such obligation will **only** arise (subject to the de minimis rule discussed at [74]) for a shareholder who:
- has been granted RWT-exempt status by the Commissioner;⁴⁴ or
 - pays the interest as part of a taxable activity (see Example | Taura 11).⁴⁵
72. A “taxable activity”⁴⁶ generally requires all of the following to apply:
- There must be an activity, which is a broad concept involving a combination of tasks undertaken, or a series of acts or course of conduct pursued by a person.
 - The activity must be carried on continuously or regularly.
 - The activity must involve or be intended to involve the supply of goods and services to any other person.
 - The supply or intended supply of goods and services must be for consideration.
73. Given the nature of an overdrawn shareholder loan account, it is expected that the corresponding interest would **not** be paid as part of a taxable activity in most cases (see Example | Taura 12).
74. Even if a shareholder meets the above requirements for withholding RWT from interest, a de minimis threshold of \$5,000 is in place to relieve them from withholding where they pay only small amounts of interest each year.⁴⁷ This applies to a shareholder who:
- pays \$5,000 or less in total interest⁴⁸ in each of the current year and the year before the current year; and
 - is granted RWT exempt status because they have no net income for the period or are expecting to have an RWT refund of \$500 or more.⁴⁹

⁴⁴ Section RE 4(3)(a).

⁴⁵ Section RE 4(3)(b).

⁴⁶ See s YA 1 – meaning of “taxable activity” and s 6 of the Goods and Services Tax Act 1985.

⁴⁷ Section RE 10(1) and (2).

⁴⁸ The total interest amount does not include interest derived by a person who has RWT-exempt status. This means that the total interest amount would not include interest paid to most New Zealand financial institutions (who should have RWT-exempt status). For example, interest on a mortgage with a New Zealand bank would not be counted towards the \$5,000 de minimis threshold.

⁴⁹ Section RE 10(1)(b); and s 321 of the TAA.

75. Further, for a shareholder who pays interest as part of a taxable activity and who does not have RWT-exempt status, the threshold amount counts only the interest that relates to the taxable activity. This means the liability to withhold RWT only arises for such a shareholder if the amount of interest relating to the taxable activity is more than \$5,000 for the year.⁵⁰

Example | Taura 11 – RWT withholding obligations

Following on from Example | Taura 10, this example assumes JVES does not have RWT-exempt status.

On 1 April 2023, Jin borrows \$200,000 (the Business Loan) from JVES to set up a side business of composting and worm farming from his lifestyle block. As part of this side business, he collects organic waste from his neighbours to turn into compost using vermiculture techniques and he sells his compost and compost worms regularly on online platforms. He carries out this side business in his personal capacity.

The Business Loan is repayable on demand, and interest equal to the applicable Inland Revenue prescribed rate is to be charged on the daily outstanding balance of the loan on a simple (non-compounding) basis. Jin and JVES also agree that the Business Loan and Jin's shareholder loan account should be recorded in different accounts to make it easier to identify interest on the respective loans.

Jin is entitled to claim a deduction for interest incurred on the Business Loan. This is because the loan is applied to a business and therefore meets the general permission. None of the general limitations apply.

Between 1 April 2023 and 31 March 2024, Jin does not make any repayments towards the Business Loan and does not apply any income from JVES for the year towards repaying the loan.

On 8 June 2024, JVES finalises its accounts for the year ended 31 March 2024, which includes finalising the quantum of the interest accrued on the Business Loan (being over \$5,000).

On 10 June 2024, Jin pays the interest accrued to 31 March 2024. His accountant advises him that because he applied the Business Loan towards a "taxable activity" and the interest amount exceeds the \$5,000 de minimis threshold, he needs to deduct RWT from the interest paid to JVES and return it to Inland Revenue by 20 July 2024. Jin instructs his accountant to proceed with this and the accountant returns the RWT to Inland Revenue on 20 July 2024.

⁵⁰ Section RE 10(3).

Jin's composting business is a "taxable activity" because:

- it involves an activity of turning waste into compost and raising compost worms;
- the activity is carried on continuously and regularly, as is evidenced from his constant collection of organic waste, the composting processes and then his selling of the resulting compost and worms; and
- there is a supply of goods for consideration (ie, money).

Jin applied the Business Loan towards the composting taxable activity. The interest obligation arises from that taxable activity and so he makes the payment of interest in carrying on the taxable activity.

Example | Tauria 12 – No RWT withholding obligation

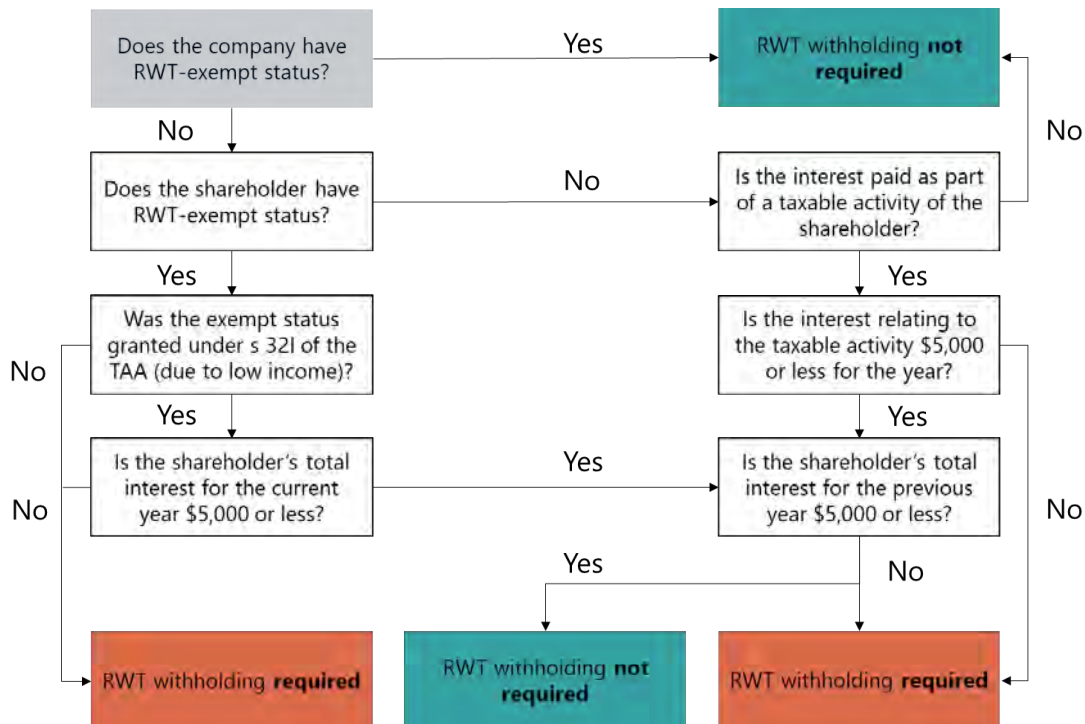
Kim is a shareholder-employee of Tax Titans Advisory Limited (TTA). She draws funds regularly from her shareholder loan account in TTA to help pay for her personal mortgage and groceries.

For the year ending 31 March 2024, Kim's shareholder salary is not enough to repay all the drawings she took prior to year end. As agreed in advance between TTA and Kim, TTA charges interest at the Inland Revenue prescribed rate on the daily overdrawn balance of Kim's shareholder loan account.

As Kim does not have RWT-exempt status and does not apply her drawings towards a taxable activity, there is no obligation to withhold RWT when the interest is paid (or credited via journal entries) to TTA.

76. Shareholders are not required to deduct RWT from interest paid to a company that has RWT-exempt status. Figure | Hoahoa 2 steps through the questions that are relevant when determining whether or not a shareholder needs to withhold RWT from what they pay on an overdrawn shareholder loan account.

Figure | Hoahoa 2: Is a shareholder required to withhold RWT from interest they have paid?



77. For more information on how to calculate and return RWT, please refer to the **Resident withholding tax on interest (RWT) payer’s guide – [IR283](#)**.

Investment income reporting rules

- 78. Certain people who pay interest to another person have an obligation to report information to Inland Revenue under the investment income reporting rules. However, as with the RWT withholding rules discussed from [71], it is expected that most shareholders with an overdrawn shareholder loan account would not have such an obligation.
- 79. The few shareholders who have an obligation to withhold RWT on interest paid on their overdrawn shareholder loan accounts will need to report specified information to Inland Revenue.⁵¹ Please refer to [Payers of interest – reporting requirements](#) on the Inland Revenue website for more information on the requirements as well as how to report electronically.
- 80. Reporting of the required information is due by the 20th of the month following the month in which the interest is paid to or derived by the company (see Example | Tairua 13).⁵² The month of payment is generally more relevant in practice than the month

⁵¹ Section 25E(1)(a) of the TAA.

⁵² Section 25F(1) of the TAA.

when the company derives the interest. This is because RWT is also due by the 20th of the month following the month of payment.

Example | Taura 13 – Reporting when RWT is required to be deducted

This example follows on from Example | Taura 11.

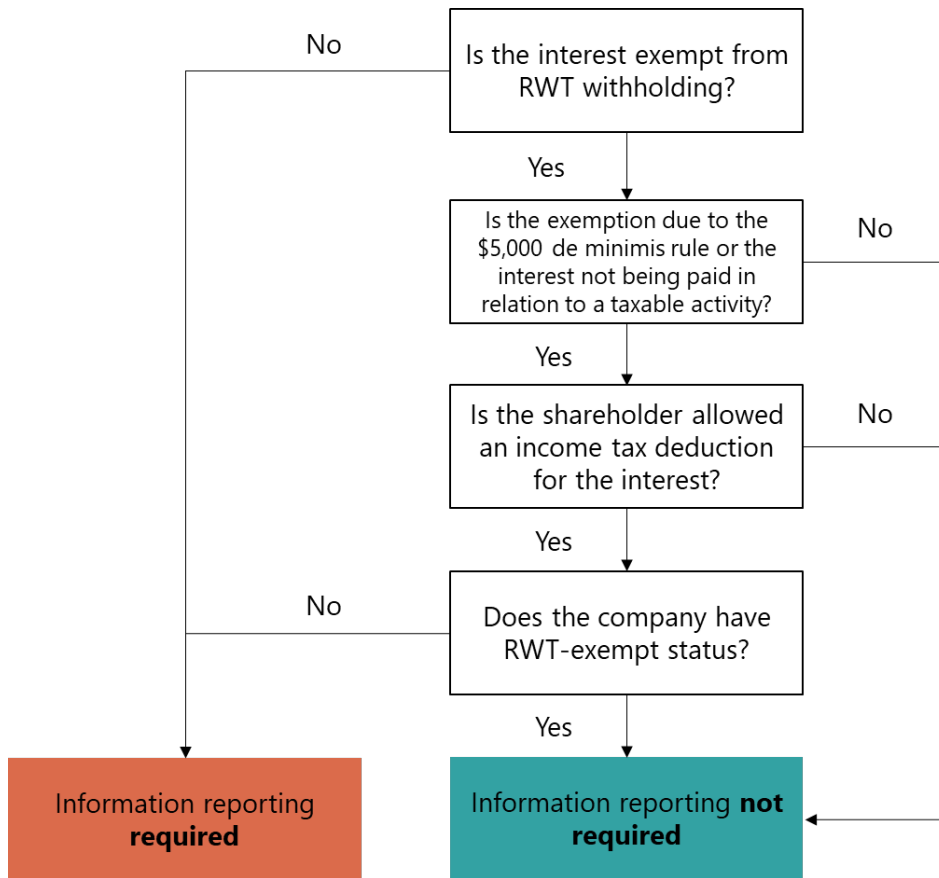
Jin is required to report information on the interest and the interest recipient (ie, JVES) to Inland Revenue because he has an RWT obligation in respect of interest paid to JVES on the Business Loan.

As the interest is paid on 10 June 2024, Jin needs to report this information by 20 July 2024, which is also the due date for the payment of the RWT deducted from the interest.

81. A shareholder also has a reporting obligation⁵³ where they have no RWT withholding obligations on interest but all of the following apply:
 - The interest is not subject to RWT because it is not paid in carrying on a taxable activity or is exempt under the \$5,000 de minimis rule.
 - The shareholder is allowed an income tax deduction for the interest.
 - The interest is paid to a person (ie, the company) who does not have RWT-exempt status.
82. Again, it is expected that only a few shareholders will meet all of the criteria at [81] for their overdrawn shareholder loan accounts. Particularly given the income tax deduction criterion would not apply to shareholders who merely draw funds for private or domestic purposes. [Figure | Hoahoa 3](#) steps through the questions that are relevant in determining whether a shareholder needs to report information under the investment income reporting rules.

⁵³ Section 25E(1)(j) and (2) of the TAA.

Figure | Hoahoa 3: Is the shareholder required to report information under the investment income reporting rules?



- 83. For the few shareholders who meet the listed criteria, please refer to [Interest payers not required to withhold – reporting requirements](#) on the Inland Revenue website. This provides more information on the requirements as well as on how to report electronically.
- 84. The required information is due with the shareholder’s income tax return for the corresponding year (see Example | Taurira 14).⁵⁴

Example | Taurira 14 – Reporting obligation when not required to withhold

Dave is a shareholder of Rocket To The Moon Limited (RTTM). He is not an employee of RTTM and does not take regular drawings from the company. Neither Dave nor RTTM has RWT-exempt status.

In late 2023, Dave catches wind of a “hot” new New Zealand share investment, Envy-Dia. Short on funds, Dave approaches the director of RTTM for a loan to buy shares in Envy-Dia to make a quick profit.

⁵⁴ Section 25N(b) of the TAA.

On 1 March 2024, Dave draws \$40,000 from RTTM and uses the full amount to buy Envy-Dia shares. He agrees to apply any dividends he receives from RTTM towards the repayment of this loan. Dave also agrees to pay interest at the Inland Revenue prescribed rate on the daily outstanding balance of his loan (simple method, as opposed to compounding), and to treat the backdating rule in s CD 39(9) (see [40]) as if it also backdates the repayment for the purpose of calculating the actual interest payable on the loan.

On 31 May 2024, RTTM declares and pays a dividend. Dave's share is \$20,000 and is applied to repay his loan. Under s CD 39(9) as well as the agreed loan terms, the repayment is backdated to 1 April 2024. On the same day, Dave sells his Envy-Dia shares for a profit and repays the balance of his loan plus the interest accrued to 31 May 2024 of \$566.81, calculated as follows:

From 1 March 2024 to 31 March 2024: $\$40,000 \times 8.41\% \times \frac{31}{365} = \285.71

From 1 April 2024 to 31 May 2024: $\$20,000 \times 8.41\% \times \frac{61}{365} = \281.10

Dave does not need to withhold RWT on the interest payable to RTTM because the one-off share transaction does not amount to a "taxable activity"⁵⁵ and he does not have RWT-exempt status.

However, Dave does have a reporting obligation under the investment income reporting rules as he will claim a deduction for the interest he incurs on the loan. This is because the share sale gives rise to taxable income (as he bought the shares for the purpose of disposal) and therefore interest incurred to acquire the shares is deductible.

Assuming Dave is required to account for financial arrangements income and expenditure on an accrual-basis,⁵⁶ the required information is due:

- when Dave files his income tax return for the year ending 31 March 2024, on interest incurred between 1 March 2024 and 31 March 2024; and
- when Dave files his income tax return for the year ending 31 March 2025, on interest incurred between 1 April 2024 and 31 May 2024.

Alternatively, if Dave is a cash basis person, he will need to report the required information when he files his income tax return for the year ending 31 March 2025. This is because, as a cash basis person, he accounts for the interest when the interest is paid. As the date of interest payment is 31 May 2024, which falls

⁵⁵ Note – this does not mean proceeds from Dave's share disposal are not taxable. Refer to [71] for the meaning of "taxable activity".

⁵⁶ To be consistent with RTTM's FA basis under s EW 59(b).

in the year ending 31 March 2025, the required information is due when Dave files his tax return for that year.

Interest income for company

85. Where a company charges interest on an overdrawn shareholder loan account, the interest is taxable income for the company. The company will generally need to apply the FA rules, which determine when it derives interest income from a loan.
86. The FA rules essentially require parties to a financial arrangement to spread income or expenditure from the arrangement over its term using specified methods, instead of recognising the income or expenditure as it is received or paid. The key purposes of the rules are to prevent deductions for expenditure from being accelerated and income recognition from being deferred.
87. A number of spreading methods in the FA rules may apply based on a company's particular circumstances. One common method for smaller companies is the straight-line method.⁵⁷ This method requires only simple calculations and should generally produce the same result as would come from applying the relevant interest rate to the daily outstanding balance of the overdrawn shareholder loan account for each day of the relevant income year (as shown in Example | Taurira 14).⁵⁸
88. A company may use the straight-line method if it meets all of the following criteria:
 - The total value of all the financial arrangements to which the company is a party in an income year has been \$1,850,000 or less on every day in the income year.
 - The straight-line method is used for all financial arrangements to which the company is party at the end of the year and for which it can use the method.
 - The company does not use IFRS⁵⁹ rules to prepare financial statements and to report for financial arrangements.
89. Separately, a company may qualify for the concessionary rules as discussed at [67]. That is, some companies may be able to be exempt from applying the FA rules to an

⁵⁷ Section EW 17.

⁵⁸ See **DET G24: Straight line method**, which sets out the principles and calculation methods of the straight-line method (in particular "Method B"), and **DET G1A: Apportionment of income and expenditure on a daily basis**, which requires financial arrangements income and expenditure for a period to be apportioned on a straight-line basis among the income years in which the period falls, according to the number of days in the period.

⁵⁹ As defined in s YA 1 to mean "a New Zealand Equivalent to International Financial Reporting Standard, in effect under the Financial Reporting Act 2013, and as amended from time to time or an equivalent standard issued in its place".

overdrawn shareholder loan account if the \$50,000 VPDI exception applies.⁶⁰ However, given the low threshold, it is expected that few companies would qualify for this exception.

90. In addition, some companies may be able to qualify as cash basis persons for the purpose of the FA rules. Where they qualify, they do not need to spread financial arrangements income or expenditure under the FA rules.

Claiming RWT credits

91. Where RWT is deducted from interest received from a shareholder, the company can claim a tax credit for that RWT in its income tax return for the year in which it derives the interest,⁶¹ provided that the shareholder has withheld the RWT and paid it to Inland Revenue.

Example | Taura 15 – Interest and RWT calculated after year end

This example follows on from Example | Taura 13.

On 30 November 2024, JVES's accountant prepares the company's tax return for the year ending 31 March 2024. JVES returns its income on an accrual basis. The accountant therefore includes the interest income accrued on Jin's loan to 31 March 2024 in the tax return, even though the interest is only paid in June 2024.

The accountant also claims a tax credit for the RWT that Jin paid to Inland Revenue on 20 July 2024 as the RWT relates to interest income included in the 31 March 2024 tax return and has been returned at the time of filing the return.

Relieving a shareholder from repaying overdrawn balance

92. Because the affairs of close companies and their shareholders are intimately linked, sometimes a company may agree that the shareholder does not need to repay the balance of their overdrawn loan account. If a shareholder is relieved of their obligation to repay their overdrawn shareholder loan account balance, income will arise under the dividend rules or the FA rules.

⁶⁰ Another exception in s EW 5(10) excludes a lender from applying the FA rules to an interest-free New Zealand-denominated loan that is repayable on demand. However, that is not relevant to this discussion of interest-bearing loans.

⁶¹ Section LB 3(1).

Application of the dividend rules

93. Under the dividend rules, a “transfer of company value” occurs when a company releases a shareholder from repaying a loan without receiving adequate value from the shareholder in return.⁶² As discussed from [30], in most cases the Commissioner considers such transfers would be caused by the shareholder’s shareholding in the company, giving rise to a dividend.⁶³ This is because the company is unlikely to release other debtors from paying amounts they owe it, meaning the release occurred because the debtor is a shareholder. The amount of the dividend is the market value of the loan forgiven (see Example | Taura 16).⁶⁴ This applies regardless of whether the shareholder is an employee of the company.

Example | Taura 16 – Dividend from debt forgiveness

Shingi is a shareholder in Travel The World In Luxury Limited (TTWIL), which operates a travel advisory business.

In the 2024 income tax year, Shingi’s shareholder loan account is overdrawn by \$5,000 and TTWIL agrees to release Shingi from having to repay this balance.

The release of debt results in a transfer of company value from TTWIL to Shingi. This is because TTWIL has provided money or money’s worth to Shingi but Shingi has not provided anything in return.

Shingi’s shareholding in TTWIL has caused the transfer of company value as the company would not have provided this value to an unrelated third party.

A dividend therefore arises for Shingi unless one of the dividend exclusions⁶⁵ applies.

94. If the debt forgiveness occurs in the course of a company’s liquidation,⁶⁶ the dividend amount may be reduced by any available capital distribution amount and any available subscribed capital in the company.⁶⁷

⁶² Section CD 5(2).

⁶³ See also *Campbell and Davis v Commissioner of Inland Revenue* (1983) 6 NZTC 61,655.

⁶⁴ Section CD 38(1) and (2).

⁶⁵ See ss CD 22 to CD 37.

⁶⁶ For information on when a company is considered to be in “liquidation”, refer to **BR Pub 14/09: Income tax – meaning of “anything occurring on liquidation” when a company requests removal from the register of companies**, which relates to short-form liquidations, or **QB 20/03: First step legally necessary to achieve liquidation when a liquidator is appointed**.

⁶⁷ Section CD 26(1)(a) and (2).

Application of the FA rules

95. In most cases,⁶⁸ a base price adjustment (BPA) must also be calculated under the FA rules (in addition to applying the dividend rules above) when a specified event⁶⁹ occurs, including when one of the following applies:
- The shareholder is discharged from making all remaining payments owed on their overdrawn shareholder loan account without fully adequate consideration.
 - The shareholder is released from making all remaining payments owed on their overdrawn shareholder loan account under the Insolvency Act 2006 or the Companies Act 1993.
 - All remaining payments owed on the shareholder's overdrawn shareholder loan account become irrecoverable or unenforceable through the lapse of time.
96. Where a company forgives the outstanding balance on an overdrawn shareholder loan account, the shareholder is considered to have been discharged from making the remaining payments they owe on the account without fully adequate consideration. This means the two parties are required to calculate a BPA.
97. Another circumstance requiring a BPA calculation is where the outstanding debt becomes irrecoverable or unenforceable through the lapse of time. This can arise through the application of the Limitation Act 2010 where the 6-year limitation period⁷⁰ for a creditor to recover a debt has expired.
98. Notably, the fact that a party to the loan may be a cash basis person for the purpose of the FA rules does not affect their obligation to perform a BPA calculation. However, if they qualify for the VPDI exception in respect of the overdrawn shareholder loan account, they will not need to perform a BPA calculation.
99. It is also possible that a company may not need to apply the FA rules to an overdrawn shareholder loan account if the loan is:
- in New Zealand dollars; and
 - interest-free; and
 - repayable on demand.⁷¹

⁶⁸ A BPA is not required if the overdrawn shareholder loan account is an "excepted financial arrangement" under s EW 5 – for example, if the VPDI exception (as discussed from [58]) applies. However, it is expected that only on rare occasions a shareholder loan account would be an excepted financial arrangement.

⁶⁹ Section EW 29, in particular, subss (9), (10) and (12).

⁷⁰ Section 11(1) of the Limitation Act 2010.

⁷¹ Section EW 5(10).

100. Accordingly, where an overdrawn shareholder loan account meets the above criteria, the company will not need to perform a BPA calculation for that loan. This, however, does not affect the relevant shareholder's obligations under the FA rules, which are assessed independently from the obligations of the company.

BPA calculation

101. Under a debt forgiveness scenario, both the lender (eg, the company) and the borrower (eg, the shareholder) will need to separately calculate their own BPA.

102. A BPA is calculated using the following prescribed formula:⁷²

consideration – income + expenditure + amount remitted

103. Each of the components in the BPA formula is discussed in further detail below:

- Consideration – see [105] to [110] and Example | Taura 17.
- Income – see [111] to [113] and Example | Taura 18.
- Expenditure – see [114] to [116] and Example | Taura 19.
- Amount remitted – see [117] and [118], and Example | Taura 20.

104. The BPA calculation and outcomes are also discussed from [119] to [123] and illustrated in Example | Taura 20, Example | Taura 21 and Example | Taura 22.

Consideration

105. The **consideration** component⁷³ of the formula is all consideration that has been paid, and all consideration that is or will be payable, to the person for or under the financial arrangement, **minus** all consideration that has been paid, and all consideration that is or will be payable, by the person for or under the financial arrangement.
106. The consideration for a shareholder calculating a BPA would generally be all amounts that they have received or will receive from the company in their shareholder loan account (eg, all the drawings taken by the shareholder) **minus** all amounts they have paid or will pay to the company in respect of the shareholder loan account (eg, any principal repayments or interest).
107. Consideration paid or payable by the shareholder to the company does not include the amount of debt that the company forgives. At the point in time it forgives the debt, that debt is no longer payable by the borrower.

⁷² Section EW 31(5).

⁷³ Section EW 31(7).

108. A BPA that a shareholder calculates when their overdrawn shareholder loan account balance is forgiven will generally result in a positive consideration figure. This is because, when a loan is forgiven, the borrower has received more than they have paid.
109. The consideration for a company calculating a BPA would generally be all amounts it has received or will receive from a shareholder on their shareholder loan account (eg, any repayments or interest) **minus** all amounts it has paid to the shareholder in respect of the shareholder loan account (eg, all drawings taken by the shareholder).
110. Again, consideration paid or payable to the company does not include the amount of debt that the company forgives. Therefore, a BPA that a company calculates when it forgives an overdrawn shareholder loan account balance of a shareholder will generally result in a negative consideration figure (see Example | Taurira 17).

Example | Taurira 17 – BPA consideration when debt forgiven

Mark is a shareholder-employee of Give Me That Tripple Shot Limited (Tripple Shot). He is allowed to take drawings from Tripple Shot to fund his living costs. Over the course of the year ending 31 March 2023, he takes drawings totalling \$50,000.

Tripple Shot's accountant prepares the company's 2023 accounts in June 2023. A shareholder salary of \$35,000 is allocated to Mark for the year and is applied to repay the loan. Interest is charged at the applicable Inland Revenue prescribed rate on the outstanding balance, which works out to be \$400 and is added to the loan balance.

In December 2023, Mark decides to part ways with Tripple Shot and asks the company to remit his overdrawn shareholder loan account balance. By this time, the overdrawn balance has increased by another \$25,000 to \$40,000, including the \$400 interest. The directors of Tripple Shots agree to remit the full balance of \$40,000.

Aside from the fact that a dividend of \$40,000 will arise for Mark, both Mark and Tripple Shot need to calculate a BPA.

Under the prescribed BPA formula, Mark's consideration component is calculated as:

Consideration = total consideration paid to Mark – total consideration paid by Mark

Consideration = (50,000 + 25,000) – 35,000

Consideration = 40,000

Tripple Shot's consideration component is calculated as:

*Consideration = total consideration paid to Tripple Shot
– total consideration paid by Tripple Shot*

Consideration = 35,000 – (50,000 + 25,000)

Consideration = –40,000

Income

111. In the context of an overdrawn shareholder loan account, the **income** component⁷⁴ of the formula comprises both:
- the income the person derived under the financial arrangement in earlier income years; and
 - dividends the person derived from the release of the obligation to repay the amount loaned.
112. For a shareholder, this component will likely comprise any dividend arising from the company forgiving their loan (as discussed at [93]). The reason for including such dividends is to ensure the shareholder is not taxed again on the same amounts under the FA rules.
113. For a company, this component will likely comprise any interest that it derived in the years before the year in which it is required to calculate the BPA (eg, in the year in which the loan is forgiven) (see Example | Taurira 18).

Example | Taurira 18 – Income component

Following on from Example | Taurira 17, Mark's income component is \$40,000, which represents his dividend income from the debt forgiveness. He has not derived any other income from his shareholder loan account to include in this component.

Tripple Shot's income component is \$400 (assuming it returns income on an accrual basis), which represents the interest income it derives to 31 March 2023.

Expenditure

114. The **expenditure** component⁷⁵ is the expenditure the person incurs under the financial arrangement in earlier income years.

⁷⁴ Section EW 31(9).

⁷⁵ Section EW 31(10).

115. For most shareholders, this component will mostly represent the interest charged on their overdrawn shareholder loan account, if any.
116. For a company, this component is likely to be nil as the company would generally not incur expenditure on a shareholder loan account (see Example | Taura 19).

Example | Taura 19 – Expenditure component

Following on from Example | Taura 18, Mark’s expenditure component is the \$400 of interest he incurs on the overdrawn shareholder loan account in the year ending 31 March 2023.

Tripple Shot’s expenditure component is nil as it has not incurred any expenditure on the loan account.

Amount remitted

117. The **amount remitted** component⁷⁶ is an amount that is not included in the consideration paid or payable to the person because it has been remitted by the person or by law.
118. This component is generally only relevant to the lender (eg, a company forgiving an overdrawn shareholder loan account balance) and represents the amount of debt that has been remitted by the lender or by law. Therefore, this component should be nil for a shareholder benefitting from a debt forgiveness (see Example | Taura 20).

Example | Taura 20 – Amount remitted component

Following on from Example | Taura 19, Mark’s amount remitted component is nil as the amount remitted was not payable to him.

Tripple Shot’s amount remitted component is \$40,000, which is the amount it forgives on Mark’s overdrawn shareholder loan account.

Mark’s BPA is therefore calculated as:

$$BPA = \textit{consideration} - \textit{income} + \textit{expenditure} + \textit{amount remitted}$$

$$BPA = 40,000 - 40,000 + 400 + 0$$

$$BPA = 400$$

Tripple Shot’s BPA is calculated as:

$$BPA = -40,000 - 400 + 0 + 40,000$$

⁷⁶ Section EW 31(11).

$$BPA = -400$$

BPA outcome

119. Where the outcome of a BPA calculation is positive, it is generally financial arrangements income for the person in the year for which the calculation is made. However, the positive BPA is not income to the extent to which it arises from expenditure the person incurred under the relevant financial arrangement in earlier income years and for which a deduction was denied in those income years (see Example | Taura 21).⁷⁷

Example | Taura 21 – Positive BPA outcome

Following on from Example | Taura 20, although Mark has a positive BPA of \$400, the BPA is not income because the entire \$400 arises from interest incurred on his overdrawn shareholder loan account, which represents expenditure Mark incurred under the financial arrangement. Additionally, he is denied a deduction for interest in the 2023 income year because the interest does not have a nexus to income and therefore does not meet the general permission.

This means that Mark's BPA produces no income (or deduction). As the BPA formula takes into account the income he is already required to return under the dividend rules, he is not further subject to debt remission income under the FA rules.

120. Where the outcome of a BPA calculation is negative, the amount is expenditure the person incurred in the income year for which the calculation is made.⁷⁸ Expenditure incurred under the FA rules is deemed to be interest.⁷⁹
121. A deduction may be available for the person in respect of the deemed interest. Where the person is not a company, the person may be allowed a deduction if the relevant requirements for deduction of an interest expense (as discussed at [63]) are met.
122. Where the person is a company, the company is allowed a deduction for interest expenditure incurred whether or not the expenditure satisfies the general permission.⁸⁰ The general limitations in s DA 2 may still apply, other than the capital limitation, the exempt income limitation and the withholding tax limitation. However, in the context

⁷⁷ Section EW 31(3).

⁷⁸ Section EW 31(4).

⁷⁹ See para (c) of the definition of "interest" in s YA 1.

⁸⁰ Section DB 7.

of an overdrawn shareholder loan account, it is unlikely that the relevant general limitations would apply to a company.

123. Where the above deduction rules do not apply, a deduction is allowed for the negative BPA amount to the extent the amount arises from assessable income that the person derived under the financial arrangement in earlier income years.⁸¹

Example | Taura 22 – Negative BPA outcome

Following on from Example | Taura 21, Tripple Shot has a deduction of \$400 in the 2024 income year. The -\$400 negative BPA is deemed to be interest and a deduction is allowed under s DB 7.

Notably, the BPA calculation does not allow a deduction for the \$40,000 that Tripple Shot forgives as the amount is added back under the amount remitted component.

⁸¹ Section DB 11.

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