Inland Revenue
Te Tari Taake

"TRANSITIONAL CAPITAL AMOUNT" - DEFINITION

Public Ruling - BR Pub 01/02

Note (not part of ruling): This ruling is essentially the same as public rulings BR Pub 96/6 which was published in TIB Volume Seven, No. 12, April 1996 and BR 98/1 published in TIB Volume Ten, No. 2, February 1998. BR Pub 98/1 applies up until 31 March 2001. This new ruling takes into account minor wording changes made to the legislation since BR Pub 98/1 was issued and its period of application is from 1 April 2001 to 31 March 2006.

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

Taxation Law

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This Ruling applies to the definition of factor "j" in the formula within the definition of "transitional capital amount" in section OB 1 of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

This Ruling applies to companies that liquidate on or after 1 July 1994 and distribute to shareholders the same class of capital that the company has, prior to 1 July 1994, written off against its losses.

How the Taxation Law applies to the Arrangement

The "total amount of capital paid up before 1 July 1994" in factor "j" of the formula within the definition of "transitional capital amount" includes all paid-up capital that has been, prior to 1 July 1994, written off against losses incurred by the company

The period for which this Ruling applies

This Ruling applies to liquidations (as defined in section OB 1), and to distributions from such liquidations, during the period 1 April 2001 to 31 March 2006.

This Ruling is signed by me on the 14th day of March 2001.

Martin Smith
General Manager, Adjudication & Rulings

Commentary on Public Ruling BR Pub 01/02

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 01/02 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR 98/1 (TIB Volume Ten, No. 2, February 1998 at page 4 under the heading "*Definition of "transitional capital amount").* This Ruling covers the period from 1 April 2001 to 31 March 2006.

Background

The Companies Act 1993 enacted major reforms in the company law area. One of the most significant was the removal of the concept of "paid-up capital". Consequently the Income Tax Amendment Act 1994 was enacted to accommodate the changes to company law. In particular, the Income Tax Amendment Act 1994 introduced, with application from 1 July 1994, a definition of "available subscribed capital" for tax purposes.

The Income Tax Amendment Act 1994 also repealed section 4A(1)(h) of the Income Tax Act 1976. Section 4A(1)(h) allowed the Commissioner to exclude from dividends such amount distributed to a shareholder of the company, as the Commissioner considered just and reasonable where:

- The company had reduced the amount of the paid-up capital of the shareholder by writing off with High Court approval, losses incurred by the company; and
- The company was subsequently wound up; and
- Upon the winding up of the company, an amount (whether in money or money's worth) was distributed to the shareholder in excess of the amount paid up on the shares of the shareholder.

The effect of the repeal of section 4A(1)(h), is that there is no reduction of the "available subscribed capital" of a company when the company has, prior to 1 July 1994, written off losses against paid-up capital. To calculate the available subscribed capital for companies existing prior to 1 July 1994, the "transitional capital amount" must be determined.

The terms "available subscribed capital" and "transitional capital amount" are discussed in more detail in TIB Volume Six, No. 6 - Company Law Reform (December 1994).

The definition of "transitional capital amount" was amended in 1998 by adding a new paragraph (b) - which does not affect this ruling - and, at the same time, the wording was changed to bring it into line with the current legislative style. In particular the former wording of "**aggregate** amount of capital" was changed to read "**total** amount of capital".

The Commissioner considers that this wording change does not affect the interpretation of the definition or the calculation of item "j".

Legislation

Section OB 1 states:

> " **Transitional capital amount**", of a share in a company means -
>
> (a) Unless paragraph (b) applies, the amount calculated using the formula:
>
> $$\frac{j + k}{l} \times m$$
>
> where
>
> j is the total **amount of capital paid up before 1 July 1994** for shares of the same class as the share (whenever issued and including the share), not being [Emphasis added] -
>
> (i) An amount paid up by a bonus issue made after 31 March 1982 and before 1 October 1988, except if -
> (A) The date of the acquisition, redemption, other cancellation, or liquidation falls more than 10 years after the date of the bonus issue; or
> (B) The amount was paid up by way of application of an amount of qualifying share premium; or
> (C) The relevant time is the time of liquidation of the company; or
>
> (ii) An amount paid up by a bonus issue (other than a taxable bonus issue) made on or after 1 October 1988, except if the amount was paid up by way of application of an amount of qualifying share premium; and
>
> k is the total of qualifying share premium paid to the company before 1 July 1994 for shares of that class (whenever issued and including the share), not being an amount that is later (but before 1 July 1994) applied to pay up capital on shares in the company; and
>
> l is the number of shares of that class (including the share) ever issued before the close of 30 June 1994; and
>
> m is the number of shares of that class (including the share) on issue at the close of 30 June 1994:
>
> (b) In the case of a company that is a group investment fund to which either section CZ 4A or CZ 4B applies, the value of the superannuation fund interest at the close of business on 31 March 1999. (Emphasis added).

Application of legislation

The "total amount of capital paid up before 1 July 1994" in factor "j" of the definition of "transitional capital amount" includes all paid-up capital that has been, prior to 1 July 1994, written off against losses incurred by the company. This allows a company to restore the written-off capital upon liquidation, without the distribution being treated as a dividend to the shareholders.

Example

1990	M Ltd issues 1,000 fully paid-up shares at $1 each.
1992	Pursuant to High Court approval, M Ltd writes off $500 (50 cents per share) of paid-up capital from its accumulated losses.
1994	Paid-up capital at 30 June 1994 is $500.
1995	Shareholders decide to liquidate M Ltd. There have been no movements in the capital of M Ltd since the capital reduction in 1992. After the sale of assets the distribution per share will be 75c.

Because M Ltd existed before 1 July 1994, its "available subscribed capital" is determined by calculating its "transitional capital amount". To calculate M's transitional capital amount, the following formula is used:

$$\frac{j + k}{l} \times m$$

where-

j	is paid-up capital at the close of 30 June 1994	$ 500
	add back capital reduction	$ 500
	total capital paid up before 1 July 1994 as defined in the Ruling	$1,000
k	qualifying share premium assume is	0
l	number of shares ever issued before 1 July 1994	1,000
m	shares on issue at 1 July 1994	1,000

$$\frac{\$1{,}000 + 0}{1{,}000} \times 1{,}000 = \$1{,}000 \text{ transitional capital amount}$$

The available subscribed capital per share cancelled equals $1,000/1,000 = $1 per share. The $0.75 per share distributed is not treated as a dividend as it does not exceed the available subscribed capital per share.