“PAID-UP CAPITAL AMOUNT” DEFINITION Section CD 32(4)
Public Ruling – BR Pub 06/04

> **Note** (not part of ruling): This ruling is essentially the same as Public Rulings BR Pub 96/6 published in TIB Vol 7, No 12, April 1996, BR Pub 98/1 published in TIB Vol 10, No 2, February 1998 and BR Pub 01/02 published in TIB Vol 13, No 4, April 2001. BR Pub 01/02 expired on 31 March 2006. This new ruling takes into account changes arising from the enactment of the Income Tax Act 2004. Its application period is on and following 1 April 2006 for an indefinite period.

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 2004 unless otherwise stated.

This Ruling applies to the definition of “paid-up capital” within the “available subscribed capital amount” formula in section CD 32(4)(a).

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 the definition of “paid-up capital” within the “available subscribed capital amount” formula 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, on and following 1 April 2006 for an indefinite period.

This Ruling is signed by me on the 30th day of June 2006.

Susan Price
Senior Tax Counsel

Commentary on Public Ruling BR Pub 06/04

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 06/04 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 01/02 (TIB Vol 13, No 4, April 2001 at page 8 under the heading "Definition of Transitional Capital Amount") which was issued in accordance with the Income Tax Act 1994 ("1994 Act").

On 1 April 2005 the Income Tax Act 2004 ("2004 Act") came into force. Under the 2004 Act the subject matter covered in BR Pub 01/02 is now found in the "available subscribed capital amount" formula in section CD 32.

This Ruling applies on and following 1 April 2006 for an indefinite period.

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.

In effect, section 4A(1)(h) had allowed a company, upon winding-up, to restore a loss of paid-up capital without the shareholders suffering any tax consequences.

The issue addressed in the previous rulings was whether the "available subscribed capital" formula, as prescribed in section OB 1 of the 1994 Act, performed the same function as, the now repealed, section 4A(1)(h).

This ruling updates the previous rulings by taking account of the 2004 Act, under which the "available subscribed capital" formula is now prescribed in section CD 32.

Legislation

Income Tax Act 1994

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 -
>
> (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.

Income Tax Act 2004

The relevant part of section CD 32 provides:

> **SECT CD 32 AVAILABLE SUBSCRIBED CAPITAL AMOUNT**

CD 32(1) FORMULA FOR CALCULATING AMOUNT OF AVAILABLE SUBSCRIBED CAPITAL For a share (**share**) in a company at any relevant time (**calculation time**), the amount of **available subscribed capital** is calculated using the formula -

1 July 1994 balance + subscriptions - returns.

CD 32(2) DEFINITION OF ITEMS IN FORMULA In the formula, -

(a) **1 July 1994 balance** is, -

(i) if the company existed before 1 July 1994, the amount calculated under subsection (3); and

(ii) in any other case, zero:

(b) **subscriptions**, subject to subsections (6) to (20), is the total amount of consideration that the company received, after 30 June 1994 and before the calculation time, for the issue of shares of the same class (the class) as the share:

(c) **returns**, subject to subsections (21) to (24), is the total amount of consideration that the company paid, after 30 June 1994 and before the calculation time, on the cancellation of shares in the relevant class and that was not a dividend because of section CD 14 or CD 16 or a corresponding provision of an earlier Act.

CD 32(3) 1 JULY 1994 BALANCE The 1 July 1994 balance is calculated using the formula -

$$\frac{\text{paid-up capital + premiums}}{\text{all shares issued}} \times \text{30 June 1994 shares}$$

CD 32(4) DEFINITION OF ITEMS IN FORMULA In the formula, -

(a) **paid-up capital**, subject to subsection (5) relating to bonus issues, is the total amount of capital paid up before 1 July 1994 for shares in the class:

(b) **premiums** is the total amount of qualifying share premium paid to the company before 1 July 1994 for shares in the class, but not including amounts applied before 1 July 1994 in paying up capital:

(c) **all shares issued** is the number of shares in the class ever issued at the end of 30 June 1994:

(d) **30 June 1994 shares** is the number of shares in the class on issue at the end of 30 June 1994.

Income Tax Act 1994

Under the 1994 Act, to calculate the available subscribed capital for companies existing prior to 1 July 1994, the “transitional capital amount” (as defined in section OB 1) had to be ascertained.

The terms “available subscribed capital” and “transitional capital amount” are discussed in more detail in TIB Vol 6, No 6 – Company Law Reform (December 1994).

In the “transitional capital amount” definition is “factor j”, which section OB 1 of the 1994 Act prescribed as including “the aggregate amount of capital paid up before 1 July 1994”. In Public Ruling BR Pub 96/6 (published in April 1996) the Commissioner ruled that:

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

That ruling was reissued as Public Ruling BR Pub 98/1 (published in February 1998).

The definition of "transitional capital amount" was amended in 1998 by adding a new paragraph (b) – which did not affect the previous 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 considered that this wording change did not affect the interpretation of the definition or the calculation of item "j" so the previous ruling was reissued, with the word “total” replacing the word “aggregate”, as Public Ruling BR Pub 01/02 (published in April 2001).

Income Tax Act 2004

In the 2004 Act the “available subscribed capital amount” formula is set out in section CD 32. Included in that formula, at section CD 32(2), is factor “1 July 1994 balance”, which in turn contains factor “paid-up capital” that is defined in section CD 32(4)(a) as:

> (a) **paid-up capital**, subject to subsection (5) relating to bonus issues, is the **total amount of capital paid up before 1 July 1994** for shares in the class.
>
> **[Emphasis Added]**

The Commissioner considers that the total amount of capital paid up before 1 July 1994 in the definition of “paid-up capital” includes all paid-up capital that has been, prior to 1 July 1994, written off against losses incurred by the company.

The reason for this view is that the factors “1 July 1994” and “paid-up capital” in section CD 32 are equivalent to the section OB 1 definitions of “transitional capital amount” and “factor ‘j’”, respectively, in the 1994 Act. Hence, despite the change in terminology, this ruling is equivalent to the previous rulings given in relation to ‘transitional capital amount’.

Further, it is observed that section OB 1 still contains a definition for ‘transitional capital amount’. However, that definition no longer forms part of the ‘available subscribed capital amount’ formula.

Application of legislation

The “total amount of capital paid up before 1 July 1994” in the definition of “paid-up capital” within the “available subscribed capital amount” formula 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 of the same class 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.
2003	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 will be $750 (75c per share).

Because M Ltd existed before 1 July 1994, its “available subscribed capital amount” is calculated under section CD 32, as follows:

1. To calculate M’s “available subscribed capital amount”, the following formula from section CD 32(1) is used:

   1 July 1994 balance + subscriptions – returns

   Assuming that the “subscriptions” and “returns” after 30 June 1994 are nil, the “available subscribed capital amount” will be the same as the “1 July 1994 balance”.

2. To calculate M’s “1 July 1994 balance”, the following formula from section CD 32(3) is used:

$$\frac{\textbf{paid-up capital + premiums}}{\textbf{all shares issued}} \times \textbf{30 June 1994 shares}$$

   where-

paid-up capital	is the 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	$1,000

	defined in this Ruling	
premiums	qualifying share premium assume is	0
all shares issued	number of shares ever issued before close of 30 June 1994	1,000
30 June 1994 shares	shares on issue at close of 30 June 1994	1,000

$$\frac{\$1{,}000 + 0}{1{,}000} \times 1{,}000 = \$1{,}000 = \text{“1 July 1994 balance”}$$

The “1 July 1994 balance” and, on this occasion, the “available subscribed capital amount” both equal $1,000.

The $750 (75c per share) distributed is not treated as a dividend as it does not exceed the “available subscribed capital amount” of $1,000 ($1.00 per share).