TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Business restructure

Decision date | Rā o te Whakatau: 18 December 2024

Issue date | Rā Tuku: 6 June 2025

TDS 25/14

Subjects | Kaupapa

The restructure of a business to change the ownership structure.

Taxation laws | Ture tāke

All legislative references in this summary are to the Income Tax Act 2007 (Act) unless otherwise stated.

Facts | Meka

1. The Arrangement is the restructure of a business operated by Company A under licence. Ownership of Company A was shared between two classes of shares – Class A and Class B. Company A was a New Zealand (NZ) tax resident and was not treated as tax resident of any other jurisdiction under a double tax agreement (DTA).
2. Class A shares had voting rights which were held by individuals X and Y who were close relatives. Class B shares had the distribution rights and were held by another company (Holding Co) which, in turn, was wholly owned by a family trust settled by X and Y, who were also trustees (the Family Trust). X and Y wished to make individual Z (a close relative of X and Y) the business operator. When the licensor was approached for approval to do so, it advised that the existing structure did not comply with its ownership rules and needed to do so before approval could be given. The Arrangement was undertaken to achieve both outcomes.
3. The following steps were taken:
    a. Company A declared a fully imputed dividend using its available imputation credits to Holding Co. Under a Deed of Acknowledgement of Debt and Indemnity between Company A and Holding Co the dividend was left as an interest-bearing loan from Holding Co to Company A.
    b. The licensor approved Z as the business operator on the condition that a compliant ownership structure was put in place before a certain date.
    c. A percentage of the Class A shares in Company A were transferred (at a formula-based value) to Z, comprising all X's shares and a portion of Y's shares.
    d. The Family Trust deed was varied to appoint Z as a trustee, and to make it otherwise compliant with the licensor's ownership requirements.

e. Company B was incorporated and had the same shareholding structure as Company A. The Class A voting shares were held by Y and Z in the same proportions as in Company A. The Class B non-voting shares with distribution rights were held by the Family Trust. Company B was a New Zealand (NZ) tax resident and was not treated as tax resident of any other jurisdiction under a DTA.

f. Company A and Company B were then amalgamated and continued as Company B (referred to as Company B - pre amalgamation, and the Amalgamated Company - post amalgamation) with the relevant shareholdings in Company B "converting" to shares of the same class and proportion in the Amalgamated Company. As part of the amalgamation, both Class A and Class B shares in Company A were cancelled for no consideration.

Issues | Take

4. The main issues considered in this ruling were whether entering and performing the Arrangement:

   - resulted in income under s CD 1 for Holding Co with respect to the cancellation of Class B shares in Company A for no consideration;
   - resulted in income under s CD 1 for Y and Z with respect to the cancellation of Class A shares in Company A for no consideration;
   - resulted in income under s CD 1 for Holding Co or the Amalgamated Company with respect to the amalgamation of Company A and Company B.

5. In addition, the Tax Counsel Office (TCO) considered whether the Arrangement was a "tax avoidance arrangement" under s BG 1, and whether s GB 1 applied to it.

Decisions | Whakatau

6. TCO decided that entering and performing the Arrangement did not:

   - result in income under s CD 1 for Holding Co with respect to the cancellation of Class B shares in Company A for no consideration;
   - result in income under s CD 1 for Y and Z with respect to the cancellation of Class A shares in Company A;
   - result in income under s CD 1 for Holding Co or the Amalgamated Company with respect to the amalgamation of Company A and Company B.

7. TCO also decided that ss BG 1 and GB 1 did not apply to the Arrangement.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Income for Holding Co from share cancellation

8. The issue was whether the cancellation of Holding Co's Class B shares in Company A, for no consideration, resulted in income under s CD 1.

9. Section CD 1 relevantly states a dividend derived by a taxpayer is income where:

   - there is a transfer of value from a company to a person where the cause of the transfer is a shareholding in the company (s CD 4);
   - no exceptions apply.

10. Under s CD 6, a transfer of value from a company to a person will be caused by a shareholding in a company if:

    - the recipient holds shares in the company or is associated with a shareholder;
    - the company makes the transfer because of that shareholding;
    - certain exceptions do not apply.

11. TCO considered the description of the Arrangement (see above at [1]-[3]) and concluded Holding Co did not derive any income from the cancellation of its Class B shares for no consideration. There was no "transfer of value" and as such, no dividend received by Holding Co when its shares were cancelled for no consideration.

Issue 2 | Take tuarua: Income for Persons Y and Z from share cancellation

12. The issue was whether the cancellation of Y and Z's Class A shares in Company A, for no consideration, resulted in income under s CD 1.

13. TCO considered that for the same reasons as outlined in [11] above, Y and Z did not derive any income from the cancellation of their Class A shares for no consideration.

14. TCO considered whether it was possible that a "transfer of value" did occur in relation to Y and Z's shares in Company A by virtue of their Company B shares "converting" to shares in the Amalgamated Company.

15. Z's shareholdings in Company A meant that they were an associated person of that company. Y was also an associated person of Company A under the Tripartite test (s YB 4) by virtue of being a close relative of Z. TCO noted that if a "transfer of value" from Company A does arise in relation to Y or Z's Company B shares converting to shares in the Amalgamated company, this may be a dividend to Y or Z (being caused by their shareholding in Company A).

16. However, from an economic viewpoint, Y and Z neither gained or lost value from the conversion of their Company B shares to shares in the Amalgamated company. They held the voting rights in relation to the business assets before the transfer, and they hold the voting rights in relation to the business assets after the transfer (Company A continuing within the Amalgamated company).

17. On this basis, TCO concluded that that there was no transfer of value giving rise to income under s CD 1 for Y or Z in respect of the cancellation of Class A shares in Company A for no consideration or the conversion of Company B shares to shares in the Amalgamated company.

Issue 3 | Take tuatoru: Income for Holding Co or the Amalgamated Company from amalgamation

18. The issue was whether income was derived under s CD 1 by Holding Co or the Amalgamated Company as a result of the amalgamation of Company A and Company B.

19. For Holding Co, TCO considered that the reasons for concluding that Holding Co did not derive income under s CD 1 upon the cancellation of its shares in Company A applied equally here.

20. The Amalgamated Company did receive a transfer of value from the amalgamating Company A in the form of its assets.

21. However, s CD 35 provides a limited exemption from certain amounts being a dividend when derived by an amalgamated company where the amalgamation is a "resident's restricted amalgamation". Specifically, it provides that where an amalgamated company derives an amount from an amalgamating company in a resident's restricted amalgamation, it is not a dividend where each of the amalgamating and amalgamated companies are, at the time of the amalgamation:

    - resident in NZ;
    - not treated as resident in another country under a DTA; and

- did not derive only exempt income (other than in very limited circumstances).

22. TCO considered the following facts when determining whether s CD 35 applied to the amalgamation:

    - Company A was an NZ incorporated company and an NZ resident.
    - Company A was not treated as tax resident in any other jurisdiction under a DTA.
    - Tax records showed that Company A did not derive only exempt income.
    - Company B was to be incorporated in NZ, an NZ resident, and not treated as tax resident in any other jurisdictions.

23. On this basis, TCO concluded that the amalgamation of Companies A and B was a resident's restricted amalgamation. As a result, TCO concluded the amount derived by the Amalgamated Company from Company A upon amalgamation was exempted from being a dividend under s CD 35.

Issue 6 | Take tuaono: Section BG 1

24. The issue was whether s BG 1 applied to the Arrangement.

25. Section BG 1(1) provides that a "tax avoidance arrangement" is void as against the Commissioner. Section GA 1 enables the Commissioner to make an adjustment to counteract a tax advantage obtained from or under a tax avoidance arrangement.

26. The Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289 considered it desirable to settle the approach to applying s BG 1. This approach is referred to as the Parliamentary contemplation test, which is an intensely fact-based inquiry. *Ben Nevis* has been followed in subsequent judicial decisions.

27. TCO's approach in making this decision is consistent with Interpretation Statement: *IS 23/01 Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007* (3 February 2023) (IS 23/01). IS 23/01 is not replicated in this TDS but in summary the steps are as follows:

    - Understanding the legal form of the arrangement. This involves identifying and understanding the steps and transactions that make up the arrangement, the commercial or private purposes of the arrangement and the arrangement's tax effects.
    - Determining whether the arrangement has a tax avoidance purpose or effect. This involves:

  - Identifying and understanding Parliament's purpose for the specific provisions that are used or circumvented by the arrangement.
  - Understanding the commercial and economic reality of the arrangement as a whole by using the factors identified by the courts.
  - Considering the implications of the preceding two steps and answering the ultimate question under the Parliamentary contemplation test: Does the arrangement, when viewed in a commercially and economically realistic way, make use of or circumvent the specific provisions in a manner consistent with Parliament's purpose?
- If the arrangement does have a tax avoidance purpose or effect, consider the merely incidental test.

28. Considering all the relevant facts and circumstances (noting that as this is a summary it may not contain all the facts or assumptions relevant to the decision and, therefore, cannot be relied on) TCO concluded as follows.

The "arrangement"

29. An arrangement is defined widely and includes enforceable contracts, unenforceable understandings, and all steps and transactions carrying the arrangement into effect.[1] TCO considered this involved the steps outlined above at [1]-[3], which included:

- Company A declaring a fully imputed dividend, left outstanding as a debt to Holding Co;
- Z being approved by the licensor and appointed director of Company A;
- X and Y transferring Class A shares in Company A to Z;
- variation of the Family Trust deed;
- incorporation of Company B; and
- amalgamation of Company A and Company B.

Tax Effects

30. TCO considered the Arrangement would give rise to the following tax effects:

- Holding Co as shareholder of Company A would derive a fully imputed taxable dividend.

[1] Section YA 1 of the Act.

- Holding Co would be owed a debt by Company A on which interest was payable (at Inland Revenue's prescribed rate for interest on low value loans to employees) by Company A. The interest would be taxable to Holding Co and deductible to first Company A (pre amalgamation), then the Amalgamated Company (post amalgamation).
- X and Y would make gains when they sell Class A shares to Z but based on the circumstances of their holding of those shares the gains may be expected to be treated as on capital account.
- There would be no dividend arising to the Amalgamated company or its shareholders in relation to the transfer of assets.
- There would be a new ASC position for the Amalgamated company, equal to the ASC of Company A and Company B combined.

Whether the arrangement has a tax avoidance purpose or effect

31. TCO concluded that s BG 1 did not apply to the arrangement because it did not have a tax avoidance purpose or effect. TCO considered that the specific features of the arrangement made use of the relevant provisions in a manner that was consistent with Parliament's purpose for those provisions, including:
    - the circumstances of the fully imputed dividend which suggested it was from retained earnings that have already been subject to tax at the company level;
    - interest charged on the dividend held as debt, was set at a realistic level, and was to be treated as income to Holding Co and deductible to Company A (then the Amalgamated Company post amalgamation);
    - the disposal of capital items, being the shares X and Y sold to Z not giving rise to income (under ss CA 1(2), CB 1, CB 3, CB 4, or CB 5);
    - the exclusion of the transfer of value between Company A and the Amalgamated Company from being a dividend because it occurred within a resident's restricted amalgamation; and
    - the absence of an uplift of the ASC of the Amalgamated company post amalgamation.
32. Further, the Arrangement achieved its intended outcomes, and the transactions undertaken were commercially and economically realistic, including:
    - The familial relationships between the parties provided a background as to why the parties chose to transfer control without any consideration passing as would ordinarily be expected in a transaction between third parties.

- It is within ordinary commercial practice for a business anticipating a substantial change in shareholding to pay out a fully imputed dividend to clear retained earnings into the shareholder's possession before shareholder continuity is lost.
- An amalgamation achieved the required structure without the necessity of novating contracts (or terminating and entering new contracts), or the sale or other transfer of assets, as would be required if instead assets were sold.

33. Given these conclusions it was not necessary for TCO to consider the merely incidental test.

Issue 6 | Take tuaono: Section GB 1

34. The issue was whether s GB 1 applied to the Arrangement.

35. Section GB 1(1) is a specific anti-avoidance rule relating to dividend stripping or dividend substitution. The section requires three things:

- a disposal of shares;
- the disposal is part of a tax avoidance arrangement;
- some or all the consideration derived from the disposal is in substitution for a dividend.

36. All three requirements must be satisfied for the provision to apply and where it does the amount derived in substitution for a dividend is treated as a dividend.

37. TCO considered that s GB 1 did not apply as the disposal of shares in the arrangement was not part of a tax avoidance arrangement. Further, TCO noted there was a genuine commercial and personal rationale for the transfer of shares reflecting the parties' desire that Z take over the business.

 See page 1 for details.