Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Off-market share cancellation

Decision date | Rā o te Whakatau: 15 December 2025

Issue date | Rā Tuku: 14 May 2026

TDS 26/04

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This document is a summary of the original technical decision so it may not contain all the facts or assumptions relevant to that decision.

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Subjects | Kaupapa

This item summarises a private ruling about whether a share cancellation payment was in lieu of a dividend under s CD 22 or was a dividend under s CD 4, whether the share-for-share exchange limitation in s CD 43 applied, and whether s BG 1 applied to vary these outcomes.

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. Company A is a New Zealand resident holding company that wholly owns Company B.
2. Company A was incorporated several years before 1 July 1994 as part of a capital restructure involving a share-for-share exchange, with Company A becoming the holding company for Company B by acquiring the shares in Company B at market value. Company A's paid-up capital on incorporation was substantially greater than Company B's due to the appreciation of Company B's assets since its incorporation.
3. The Arrangement is the off-market, pro rata cancellation of ordinary shares in Company A, occurring in two separate tranches to distribute the value of capital assets in Company A's New Zealand wholly-owned group. The capital assets are being sold because the trading operations of Company A's subsidiaries have ceased and Company A and its subsidiaries are being wound up in contemplation of liquidation.

Issues | Take

4. The main issues considered in this ruling were whether:
   - any part of the share cancellation payments was made in lieu of a dividend under s CD 22(6);
   - any part of the share cancellation payments was a dividend under s CD 4, having regard to the return-of-capital exclusion in s CD 22;
   - the share-for-share exchange limitation in s CD 43 applied to limit Company A's available subscribed capital (ASC); and
   - s BG 1 applied to vary the above outcomes.

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Decisions | Whakatau

5. The Tax Counsel Office (TCO) decided:
   - no part of either cancellation payment was in lieu of the payment of a dividend for the purposes of s CD 22(6);
   - no part of either cancellation payment was a dividend under s CD 4;
   - the share-for-share exchange limitation in s CD 43 did not apply; and
   - s BG 1 did not apply to vary the above outcomes.
6. TCO's decision was subject to two conditions:
   - The amount paid for each cancellation would be at least 10% of the market value of all ordinary shares in Company A at the time Company A first gives notice to shareholders of the cancellation.
   - The amount Company A paid for each share cancelled would be less than or equal to the available subscribed capital per share calculated under the "ordering rule" in s CD 23(1).

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Whether any part of the share cancellation payments was made in lieu of a dividend under s CD 22(6)

7. Under s CD 22, an amount paid by a company to a shareholder for the off-market cancellation of a share is not a dividend to the extent it is less than or equal to the company's ASC, provided that one of the bright-line tests in s CD 22(3) is met and no part of the payment is in lieu of the payment of a dividend (s CD 22(6)). The factors relevant to applying s CD 22(6) are set out in s CD 22(7).
8. Section CD 22(7) provides that when considering whether a share cancellation payment is in lieu of the payment of a dividend the factors to be considered are:
   - the nature and amount of dividends paid by the company before or after the cancellation;
   - the issue of shares in the company after the cancellation;

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- the expressed purpose or purposes of the cancellation; and
- any other relevant factor.

9. Although the amounts of the dividends paid by Company A in the years preceding the Cancellations had reduced, at first, to about half of earlier dividend amounts and then to nil, this was explained by the deterioration in trading conditions over those years.

10. It is intended that once all the capital assets held by the wholly-owned group have been sold, both Company A and Company B will be liquidated. Therefore, it is not intended that Company A will issue any shares after the Cancellations.

11. The expressed purpose of the Cancellations was to return capital to Company A's shareholders following the sale of capital assets.

12. The other factors considered relevant by the Commissioner as outlined in Interpretation Statement **IS 25/19: Income Tax – Whether an off-market share cancellation is made in lieu of the payment of a dividend** (the Statement) indicated that no part of either Cancellation payment was in lieu of the payment of a dividend. They are whether:
    - the capital reduction is part of the downsizing of the company;
    - the company has sold part of the business, while returning a sizeable amount to the shareholders in addition to a dividend;
    - the company has been retaining earnings and then distributing them without any accompanying reduction of the business;
    - the capital return is an unusual one-off event.
    - the share cancellation will significantly affect the shareholders' interests (in terms of their shareholding percentages or the quantum of their invested capital);
    - the shares being cancelled are non-participating redeemable shares;
    - there are accumulated earnings in subsidiaries;
    - part of the cancellation payment will be left outstanding.

13. TCO concluded that no part of either Cancellation payment in relation to the Arrangement was in lieu of the payment of a dividend for the purposes of s CD 22(6).

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Issue 2 | Take tuarua: Whether any part of the share cancellation payments was a dividend under section CD 4

14. Section CD 4 provides that a transfer of company value from a company to a person is a dividend if the cause of the transfer is a shareholding in the company and none of the exclusions in ss CD 22 to CD 37 applies.

15. In this case, the cause of the transfer (payments for the Cancellations) is a shareholding in the company.

16. However, s CD 22 applies to exempt each of the Cancellation payments from being a dividend if:

    - one of the bright-line tests is met;
    - the company is not an unlisted trust that has chosen to use the slice rule; and
    - the anti-avoidance rule in s CD 22(6) does not apply.

17. The relevant bright line tests are that the cancellation is part of a pro rata cancellation that results in a:

    - 15% capital reduction for the company; and
    - 10% capital reduction for the company, and the Commissioner has given a notice under s CD 22(8) that no part of the payment is in lieu of the payment of a dividend.

18. The effect of s CD 22 is that the amount is not a dividend to the extent to which it is less than or equal to the ASC per share calculated under the ordering rule.

19. It was the view of TCO that the first Cancellation was expected to result in a 15% capital reduction and the second Cancellation at least a 10% capital reduction with the private ruling constituting a Commissioner notice.

20. Company A was not an unlisted trust. TCO had found that the Cancellations were not in lieu of the payment of dividends as concluded under issue 1.

21. It is a condition of the ruling that the amounts paid to the shareholders will be less than or equal to the ASC per share calculated under the ordering rule in s CD 23(1).

22. Therefore, TCO concluded that no part of either Cancellation payment was a dividend under s CD 4.

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Issue 3 | Take tuatoru: Whether available subscribed capital is limited by the share for share exchange limitation under s CD 43

23. Section CD 43 sets out the formula for calculating ASC. In broad terms, ASC is the total amount of cash or value a company has received from shareholders for shares, which can be returned tax-free on liquidation or share cancellation. The ASC formula distinguishes between paid-up capital before 1 July 1994 (the "1 July 1994 balance", defined in s CD 43(3) to (5)) and "subscriptions" received after that date (defined in s CD 43(2)(b), subject to subs (6), (6B) to (6K), (7) to (20), (20B) and (21)).

24. On the face of it, the incorporation of Company A involved a share-for-share exchange as described in s CD 43(9). If s CD 43(9) applied in this context, under s CD 43(10) the amount of consideration received for Company A's shares issued would be limited to the total ASC per share of Company B's shares that were received as consideration.

25. However, in TCO's view, the share-for-share exchange limitations in ss CD 43(9) and (10) did not apply to limit Company A's pre-1994 capital. Based on the plain and ordinary meaning of the legislation, those provisions clearly modify only the "subscriptions" component, which is confined to consideration received after 30 June 1994. They do not apply to the calculation of the 1 July 1994 balance, which is governed by a separate formula in s CD 43(3) to (5).

26. TCO cross-checked this outcome against the legislative purpose and context and concluded it was consistent with Parliament's intent. In TCO's view, the 1994 reforms were deliberately prospective, preserving historic paid-up capital for pre-1 July 1994 companies while tightening rules for future share-for-share exchanges. The legislative history and extrinsic materials confirmed Parliament was aware of the weakness in the earlier rules but chose not to apply the new limitations retrospectively.

27. Accordingly, TCO considered both the text and purpose of s CD 43 supported that the share-for-share exchange limitation did not apply to limit Company A's ASC. Company A's shares were fully paid in money's worth on its incorporation before 1 July 1994 (as the consideration received in the form of Company B's shares represented market value, being shares in an asset-rich operating company). Because Company A was incorporated before 1 July 1994, its pre-1 July 1994 paid-up capital was not affected by the share-for-share exchange that occurred.

28. Therefore, TCO concluded that Company A's ASC was not limited by the share-for-share exchange limitation in s CD 43.

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Issue 4 | Take tuawhā: Whether s BG 1 applies

29. 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.

30. 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.

31. TCO's approach in making this decision is consistent with *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 will not be 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. Artificiality and contrivance are significant factors.
        - Considering the implications of the preceding 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 has a tax avoidance purpose or effect that is not the sole purpose or effect of the arrangement, consider the merely incidental test. The merely incidental test considers many of the same matters that are considered under the Parliamentary contemplation test.

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32. Taking into account all of 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.

33. Arguably, the capital restructure conducted before 1 July 1994 and the proposed returns of capital were not part of the same "arrangement" for s BG 1. Objectively speaking, there appeared to be no prior planned link between the two events. If the two events did not meet the threshold of "arrangement", it may not be necessary to consider whether there is a purpose or effect of tax avoidance.

34. Even if the "arrangement" threshold were satisfied, under the Parliamentary contemplation test, TCO considered the Arrangement used the Act in a manner that is consistent with legislated options contemplated by Parliament for companies incorporated before 1 July 1994. Use of legislated options or actions existing only for tax is not artificiality or contrivance if no additional features exist. The value of Company A's paid-up capital recognised in the restructure was not artificial or inflated, as it reflected the market value of tangible assets in Company B.

35. In economic reality, the distributions Company A was seeking to make were funded by real asset sales to third parties and was occurring in the context of a wind-up of the company's operations. The duration between the restructure and the proposed buybacks also indicated that the commercial purpose at the time was genuine. There was no indication the restructure was part of any deliberate scheme or plan to artificially inflate the ASC to make tax-free distributions to the shareholders funded from internally generated gains.

36. As the specific provision and s BG 1 are to operate in tandem, the context of s CD 43 which distinguishes between these types of capital suggests that Parliament would have foreseen this outcome for a company incorporated before 1 July 1994 (such as Company A), given it was known at the time that the calculation of ASC has tax implications that may only be unwound far into the future. Accordingly, even if there was a purpose or effect of tax avoidance (due to no economic change or real financial consequence for Company B shareholders from the restructure), the tax advantage arising appears within Parliament's contemplation for companies incorporated pre-1 July 1994.

37. Therefore, TCO concluded that the Arrangement did not have a tax avoidance purpose or effect, and s BG 1 did not apply to negate or vary the above outcomes.

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