

## PART A: IMPUTATION

Section 55 of the Act inserts into the Income Tax Act 1976 Part XIA - sections 394A to 394ZJ - which contains the provisions implementing the imputation regime.

### **Application**

The new Part XIA applies from the income year which commenced 1 April 1988 unless otherwise provided.

### **Section 394A - Interpretation**

This section provides various definitions for the purposes of the imputation regime. Where appropriate, there is comment upon relevant definitions where these are used in the substantive sections.

### **Section 394B - Companies required to maintain imputation credit accounts**

Unless excluded by subsection (2) of this section, every company resident in New Zealand is required, with effect from 1 April 1988, to maintain an imputation credit account (ICA) for each imputation year. As a unit trust is deemed to be a company for the purposes of the Income Tax Act, every unit trust will also be required to maintain an ICA subject to the exclusions outlined below.

“Imputation year” is defined in section 394A as the period from 1 April to the following 31 March. Companies which have non-standard balance dates are nevertheless required to operate the ICA on a 1 April to 31 March basis.

Any company required to maintain an ICA is an “imputation credit account company”.

There are several types of companies which are not permitted to maintain ICAs. These are:

1. **Non-resident companies.** Where a company is non-resident for all or part of a year it may not operate an account for the period during which it is non-resident.
2. **A company acting only in the capacity of trustee.** Where a company acts as trustee, the rules applying to trustee/beneficiary apply.

However there is an exception to this in that a company which is a group investment fund deriving category A income must operate an ICA.

‘Group investment fund’ and ‘category A income’ are defined in section 394A and pick up the meaning of those terms in section 211A(1). The reason for requiring group investment funds with category A income to maintain an ICA is that, for tax purposes, group investment funds are treated as companies in respect of category A income and all category A income distributed to an investor is a dividend (section 4(2)).

Where a company acts in a dual capacity (both as a trustee company and a company carrying on other business), it is required to maintain an ICA in respect of its non-trustee business.

3. **A company whose constitution prohibits all of its income from being distributed to any proprietor member or shareholder.** This would include incorporated clubs and societies.
4. **A company which is exempt from tax - for example, an incorporated charity.** However, if a company solely derives dividend income that is exempt from tax, that company must operate an ICA.
5. **A company to which section 204 applies where that company is solely engaged in the business of life insurance or reinsurance.**

Where a company has both a life insurance business in addition to other business, it will be required to maintain an ICA in respect of its other business. In such a case, no debits or credits arise to the extent that they relate to the life insurance business.

### **Section 394C - Imputation Credit Account**

Every company must record as its opening balance on 1 April in each year the amount of the closing balance as at the previous 31 March.

The opening balance as at 1 April 1988 will be nil. Where payments of provisional tax are made prior to 1 April 1988 in respect of the income year commencing on April 1988 by, for example, early balancing companies, a credit will arise on 1 April of the amount paid (see section 394ZI).

In addition, debits and credits to the account are to be recorded as they arise under sections 394D and 394E.

### **Section 394D - Credits to the ICA**

Section 394D sets out the circumstances in which credits arise to the ICA and the timing of the credit entries.

The following amounts arise as credits to the ICA:

#### 1. New Zealand income tax paid

The amount of income tax paid by the company during the imputation year. "Income tax", as defined in section 394A, refers only to New Zealand income tax and excludes penal tax, excess retention tax, additional tax by way of penalty, fringe benefit tax and interest payable by the Commissioner or taxpayer in relation to under- or over-payment of provisional tax. Non-resident withholding tax imposed under the Act is not income tax.

The credit arises on the date of payment of the tax or on 1 April 1989 if tax is paid before that date in respect of the 1989 income year.

However, a credit does not arise for income tax paid in the following circumstances:

- (a) Income tax paid by a company in respect of its activities when acting in the capacity of trustee
- (b) Income tax paid by a life insurance (section 204) company in respect of income derived for the benefit of policyholders
- (c) Income tax which a group investment fund deriving category A income pays in relation to category B income
- (d) Where a company which has not been an imputation credit account company becomes one, income tax paid in respect of income derived when the company was not an ICA company. For instance, where an overseas company
- (e) Where 'further income tax' is paid, a credit will arise for the 'further income tax' on the date it is paid (see item 2 below). 'Further income tax' is able to be offset against a future liability for income tax. Under para. (v) of subsection (1), where such an offset occurs, there is, of course, no credit to the ICA for the amount of tax which is 'paid' by means of the offset.
- (f) Where income tax is paid after 1 April 1988 in relation to any income year preceding the 1989 income year, no credit arises for the tax paid.

#### 2. Further income tax

A credit arises for payment of 'further income tax' on the date the tax is paid. 'Further income tax' is an amount of tax that is payable under section 394L if the ICA has a debit balance at the end of the imputation year (refer to the discussion on that section at page 13).

#### 3. Excess Retention Tax

A credit arises on the date of payment of ERT assessed on an insufficient distribution of income derived during an income year commencing on or after 1 April 1988.

#### 4. Imputation Credits attached to Dividends Received

Where imputation credits are attached to a dividend received by a company, a credit arises to the ICA of that company of the amount of the credit attached to the dividend (refer to exception in next paragraph). The credit arises at the time the dividend was paid. The term 'paid' is defined in section 394A to include "distributed, credited, or dealt with in the interest of or on behalf of".

An exception is where a company is assessable on its dividend income - for example a life insurance company. In such a case the company may offset the credit against its tax liability for that income year and no credit will arise to the ICA

#### 5. Dividend withholding payment credits attached to Dividends Received

As noted in Part B of this commentary, a company has the option of operating a dividend withholding payment account (DWPA) - it is not mandatory. Where it chooses not to do so any withholding payment credits attached to dividends which it receives give rise to a credit in the company's ICA. The credit arises at the time the dividend was paid.

#### 6. Dividend withholding payment made on Foreign Source Dividends

The dividend withholding payment regime is discussed in detail in Part B of this commentary. Broadly, it requires a deduction to be made by a New Zealand resident company on receipt of a foreign dividend. The amount deducted is known as a dividend withholding payment and is paid quarterly to the Commissioner by the resident company. Where a dividend withholding payment is made at a time when the resident company does not operate a DWPA, the amount paid gives rise to a credit in the ICA. The credit arises on the date of payment of the dividend withholding payment.

#### 7. End of year balance in dividend withholding payment account

A company which operates a DWPA may transfer to the ICA all or part of a credit balance in the DWPA at 31 March (section 394ZZE). Where this election is made, the amount transferred will be a credit to the ICA which arises on the date of transfer. Note that credits cannot be transferred from the ICA to the WPA.

#### 8. Credit balance in branch equivalent tax account (BETA)

There is a detailed discussion of the BETA regime in Part C of this commentary. A company which operates a BETA may transfer to its ICA at any time all or part of the credit balance in the BETA (section 394ZZQ). Where it does so, the amount transferred is a credit to the ICA which arises at the time of transfer. Note that except where a debit arises to the ICA when a corresponding credit arises to the BETA in accordance with section 394ZZP, credits cannot be transferred from the ICA to the BETA.

#### 9. Amount of Reduction in dividend withholding payment payable

A company may use a credit in its BETA to reduce a dividend withholding payment for which the company is liable (refer to section 394ZZQ(3)). Where it does so, a credit arises to the ICA of the amount of credits in the BETA applied to reduce the liability (this amount is also a debit to the BETA). The credit arises on the date that the company is, or would have been, required to make the dividend withholding payment.

#### 10. Credit to offset previous debit for arrangement to obtain tax advantage

Where the Commissioner determines that a company has entered into an arrangement to obtain a tax advantage and determines the amount of the credit which is the subject of the arrangement, a debit arises to the ICA of that amount (section 394ZG). Under para. (j) of subsection (1), where the matter is subsequently resolved in favour of the company (whether by litigation or otherwise), a credit arises of the amount previously debited. The credit arises on the date that the debit arose.

### **Section 394E - Debits arising to the ICA**

Section 394E sets out the circumstances in which debits arise to the ICA and the timing of the debit entries.

Debits arise to the ICA in the following circumstances:

#### 1. Imputation credits attached to dividend paid by a company

Where a company attaches an imputation credit to a dividend paid by the company to a shareholder, a debit arises, on the date of payment of the dividend, of the amount of imputation credit attached.

#### 2. Refund of income tax

Where a company receives a refund of income tax (as defined in section 394A), a debit arises in the ICA, on the date of payment of the refund. The debit is equal to the amount of cash received by the company and such amount may be less than the actual refund because of the limitation in section 394M (refer to page 14 which outlines the circumstances in which the refund may be limited). Where a refund has been used in part by the Commissioner to offset an outstanding income tax liability, a debit arises for the full amount of the refund and a credit arises for the tax paid by virtue of the offset.

However, there are exceptions to this - no debit arises for:

(a) A refund of tax paid under the international tax regime where the company has an income interest in a controlled foreign company. (A debit arises to the BETA in this case - refer to page 48).

(b) A refund of income tax paid for 1988 or prior income years.

(c) A refund of income tax paid in respect of a period when the company was not an ICA company.

#### 3. Refund of Excess Retention Tax

A debit arises for the amount of any refund of ERT paid by the company in respect of an insufficient distribution of income derived during an income year beginning on or after 1 April 1988. The debit arises on the date the refund is paid.

#### 4. Allocation debit

The imputation legislation contains provisions which require companies to attach credits at the same ratio to all dividends paid during an imputation year (section 394G). These are discussed in detail on page 10. When a company is in breach of these allocation rules an allocation debit arises in the ICA (section 394G(4)). The debit arises on 31 March of the year in which the company was in breach of the rules.

#### 5. Refund of dividend withholding payment

Where a company does not operate a DWPA and receives a refund of dividend withholding payment, a debit arises to the ICA of the amount of the refund. The debit arises on the date the refund is paid.

#### 6. Credit of Income Tax to Branch Equivalent Tax Account

There is a detailed explanation of the operation of BETAs in Part C of this commentary. It is sufficient to note here that a company may elect to operate a BETA. When a BETA company files its return of income for a year, a credit arises to its BETA of the amount of tax payable under the branch equivalent tax regime (section 394ZZP(1)).

When that credit arises to the BETA, a debit to the ICA of the same amount simultaneously arises. This is because all income tax paid is credited to the ICA when it is paid and where a portion of that is tax payable under the international regime, that portion is separated out and used to offset a liability for dividend withholding payment on dividends received from a controlled foreign corporation (CFC). This avoids double tax on income received from a CFC in which the company has an income interest.

#### 7. Continuity provisions - Changes in Shareholding

A debit arises to the ICA where there is a loss of continuity of shareholding beyond the specified level. It arises on the date there is the loss of continuity. For a detailed outline of the loss of shareholder continuity provisions refer to the explanation below on the relevant provisions of section 394E.

#### 8. Arrangement to obtain a tax advantage

Where the Commissioner has determined that there has been a tax advantage arrangement and has determined the amount which is the subject of the arrangement and also the company whose ICA should be debited, a debit of that amount arises in the ICA of that company (section 394ZG). It arises at the end of the year in which the arrangement commenced (as determined by the Commissioner).

#### 9. Ceasing to be an ICA company

Where a company ceases to be an ICA company, i.e. where it becomes non-resident or is otherwise excluded from the requirement to maintain an ICA (refer section 394B(2)), a debit arises to the ICA of the amount of the credit balance in the account. The debit arises immediately before the company ceases to be an ICA company.

#### Sections 394E(1)(g), 394E(3) and 394E(4) - Loss of continuity

These provisions are designed to support the allocation rules (refer to section 394G and commentary thereon on page 10) to ensure that imputation credits cannot be retained in a company that is later sold to shareholders who can make effective use of the imputation credits.

In order to prevent this, the legislation provides that where the same shareholders cease at any time to hold shares carrying the right to 75% or more of the profits, credits in the company's ICA are cancelled by a debit entry in the ICA. The debit entry arises on the date of loss of continuity.

#### Example 1

#### ABC LTD

#### **1 February 1989**

Shareholder A holds shares carrying right to 100% of profits.

		DR	ICA CR	Bal.
		\$	\$	
Feb/March 1989	Tax paid		700	
20 June 1989	Div. paid (credits attached)	600		
30 June 1989				100 Cr

#### **30 June 1989**

Shareholder A holds shares carrying right to 70% of profits

Shareholder B holds shares carrying right to 30% of profits

30 June 1989	Loss of commonality	100		
7 July 1989	Tax paid		800	
12 July 1989	Div. paid (credits attached)	400		400 Cr

On 30 June a debit arises in the ICA of \$100 being the amount of any credit in the ICA where since the date on which the credit arose the same persons ceased to hold shares carrying the right to receive not less than 75% of the profits. Under subsection (4)(d), \$600 of the \$700 credit arising in Feb/March would not be subject to the requirement because it was allocated/extinguished prior to the continuity of shareholding ceasing.

Example 2 (assume all shares carry equal rights to profits)

**1 February 1989**

	DR	ICA CR	Bal.
	\$	\$	
Shareholder A owns 100% of shares			
Feb/March 1989 Tax paid		1000	
25 May 1989 Dividend paid (credits attached)	600		400 Cr
28 May Dividend received (credits attached)		200	600 Cr

**1 June 1989**

Shareholder A owns 80% of shares			
Shareholder B owns 20% of shares			
7 July 1989 Tax paid		600	1,200 Cr
19 July 1989 Dividend paid (credits attached)	600		600 Cr

**1 August 1989**

Shareholder A owns 70% of shares			
Shareholder B owns 20% of shares			
Shareholder C owns 10% of shares			
7 November 1989 Tax paid		700	1,300 Cr
4 December Dividend paid (credits attached)	800		500 Cr

In Example 2, credits arising in Feb/March and 28 May are the only credits arising to the ICA to which a loss of continuity applies - there was no loss of continuity between 1 June 1989 and 1 August 1989.

Under section 4(d) the required continuity of shareholding ceases on 1 August 1989. All of the 1200 credits that arose in February/March and May have been allocated prior to that date - therefore there is no debit entry on 1 August.

**Shares to be held in the same proportion**

There is a loss of continuity if shareholders do not continue to hold shares in the same proportion. Therefore if shareholder A, with shares carrying 70% of the right to receive profits, and shareholder B with 30%, exchange shares there would be a loss of continuity.

**Shareholding continuity period**

In determining a person's entitlement to profits the provisions of section 191(1) apply, as modified for the purpose by subsection 4(a). For these purposes, any reference to income year is to be read as the relevant shareholding continuity period (see next paragraph).

For the purpose of determining continuity during the life of a credit. i.e. between the credit arising and being cancelled (this is referred to in the legislation as the 'shareholding continuity period'), there are transfers of ownership of shares which do not count. These are:

- Where shares are transferred under a matrimonial agreement, the shares held by the new owner are deemed to be held by the transferee for the remainder of the shareholding continuity period.
- Where a shareholder dies during the shareholding continuity period, shares which are held by the trustee of the estate or the beneficiaries are deemed to be held by the deceased shareholder during the shareholding continuity period.

**Exclusions from Loss of Continuity Provisions**

The shareholder continuity provisions do not apply to:

- (a) Any credit arising before 16 December 1988 (which is the date the legislation received the Royal Assent) (section 394E(4)(e))
- (b) Any company which has any of its shares quoted on the NZ Stock Exchange
- (c) Any statutory producer board or wholly-owned subsidiary of a statutory producer board
- (d) Any co-operative company registered under any of the Acts listed in section 394E(3)(d)

(e) A private company (e.g. Company A) included in a specified group (defined in section 191(4)) where any member of the group (e.g. Company B) has shares quoted on the N.Z. Stock Exchange and where

(i) Company A and Company B continue to be in the specified group during the shareholding continuity period, or

(ii) during the shareholding continuity period the reason that company A failed to meet the continuity of shareholding requirement was that shares in Company B had been sold in the ordinary course of trading and less than 11% of the shares in company B were acquired by any one person or by 2 or more associated persons

#### **Section 394F - Attaching an imputation credit to a dividend**

A company which is required to operate an ICA may attach an imputation credit to a dividend. This is done at the time of payment of the dividend.

The term "dividend" is defined in section 394A. It excludes dividends paid in kind and dividends which are deductible to a company. Imputation credits may not be attached to such dividends. However, credits may be attached to taxable bonus issues.

A transitional provision provides for retrospective attachment of credits to a dividend paid during the period commencing on 1 April 1988 and ending before 1 February 1989.

#### **Section 344G - Allocation rules**

##### **1. Exceeding imputation ratio**

A company is not permitted to attach credits to a dividend at an **imputation ratio** which exceeds

$$\frac{a}{1 - a}$$

where "a" is the resident company tax rate for the income year in which the dividend is paid.

"**Imputation ratio**" is defined in section 394A to mean

$$\frac{\text{the amount of the imputation credit attached}}{\text{the amount of the dividend paid (excluding credits attached to the dividend)}}$$

Therefore for the 1989 income year the maximum ratio allowed is \$28 credits/\$72 net dividend paid. Where the company exceeds this ratio, the Commissioner will nevertheless restrict the amount of credit which may be claimed by the shareholder to a ratio of 28/72.

With the recent change in the company tax rate to 33 cents from the 1990 income year the maximum imputation ratio allowed will be \$33/\$67 in respect of dividends paid on or after 1 April 1989.

##### **2. Allocating credits at different ratios during year**

In order to prevent the "streaming" of credits to shareholders who are able to use them, section 394G requires that every distribution during an imputation year must carry credits at the same imputation ratio.

The first dividend paid by an ICA company during the year is the "benchmark dividend". All subsequent dividends paid during that imputation year must carry credits at the same ratio as the benchmark dividend.

For example, if there are no credits attached to the benchmark dividend, every subsequent dividend paid in that year would also have no credits attached.

Where a company is in breach of this provision, a debit (known as an "allocation debit") arises to the ICA of the company of an amount calculated as follows:

$$(a \times b) - c$$

where a = the amount of all dividends paid by the company during the imputation year (excluding credits attached to the dividend)

b = the lesser of

(i) the highest imputation ratio of dividends paid during the year

(ii) the maximum ratio allowable for the year (see para. 1 above)

c = the amount of all imputation credits attached to dividends paid by the company during the imputation year.

The effect of the debit to the JCA is to assume, for the purpose of the ICA, that all dividends paid during the imputation year are credited at the highest ratio.

#### Example

April 1989 Dividend paid to A and B \$10,000 with 2,000 credits

July 1989 " " \$10,000 with \$3,000 credits

The dividend paid in July is credited at a different imputation ratio to the dividend paid in April. A debit will therefore arise to the ICA of:

$$\$20,000 \times 3/10 - \$5,000 = \$1,000$$

A debit of \$1,000 will arise to the ICA of the company at the end of that imputation year (March 1990).

### **3. Ratio change declaration**

As the purpose of the allocation rules is to prevent streaming of credits, a ratio change is only permissible where a company officer completes a statutory declaration to the effect that a subsequent dividend is not being credited at a different ratio to the benchmark dividend as part of an arrangement to obtain a tax advantage (such as for the purpose of streaming of credits). The ratio change declaration is to be delivered to the Commissioner before the subsequent dividend is paid.

For the special provisions applying to statutory producer boards and co-operative companies, see pages 15 to 18.

#### **Section 394H - Company dividend statement**

When an ICA company declares a dividend, it is required to complete and retain a company dividend statement. This sets out the information listed in section 394H. The statement is to be forwarded to the Commissioner by 31 May following the end of the imputation year in which the dividend was paid.

#### **Section 394I - Shareholder dividend statement**

A company which pays a dividend with an imputation credit attached is required to give to the shareholder at the time of payment a shareholder dividend statement. Section 394I lists the information required on the statement and is self-explanatory. The non-corporate shareholder is required to attach the statement to the shareholder's income tax return when the credit is claimed.

#### **Section 394J - Annual imputation return**

An ICA company is required annually to file a record of the debits and credits to, and the opening and closing balance of, its ICA for each imputation year. This annual imputation return is to be forwarded to the Commissioner by 31 May immediately following the end of the imputation year.

In addition to the debits and credits to the account, the company should show in the return the amount of further income tax payable and the amount of imputation penalty tax payable (refer to pages 8 and 9 of this commentary).

Where the company is also a branch equivalent tax account company (see Part C below) information is required in relation to entries in its branch equivalent tax account.

#### **Subsequent Variation in Ratios**

For the 1990 and subsequent years, where either of the ratios referred to below have increased or decreased by more than 20% from those for the previous year, ICA companies must include in the return a note to that effect and an explanation of the reasons for the change.

The ratios are:

a  
b

where

a = the amount of credits (imputation and dividend withholding payment) attached to dividends paid by the company during the year

b = the amount of dividends paid by the company during the year

$\frac{c}{d}$

where

c = the amount of all debits arising to the ICA during the year

d = the amount of credits to the ICA during the year.

#### Example

In year 1 (1989) a company does not credit dividends and in the following year dividends are fully credited.

1989	credits attached	0
	dividends paid	\$7,200
1990	credits attached	\$3,300
	dividends paid	\$6,700.

The ratio a/b has increased by more than 20% and therefore the company is required to state this fact in its imputation return. An explanation of the reason for the change is to be furnished - it may simply be a change in the number of credits available in its ICA as a result of increased tax payments.

#### **Section 394K - Imputation return required upon request or cessation**

The Commissioner has the power to require a company to file a return of the entries in its ICA at any time. For instance, a return may be required if there is reason to believe that entries in the account are not correct.

Where a company ceases to be an ICA company (for example, if it becomes non-resident) the company is required to furnish within two months of its ceasing to be an ICA company an imputation return for the period from the beginning of the imputation year until the date it ceased to be an ICA company.

#### **Section 394L - Further income tax**

A company may, during an imputation year, attach credits to dividends in anticipation of credits subsequently arising in the ICA. The ICA may therefore run into debit. Where there is a debit balance at the end of 31 March, the company is required to pay to the Commissioner, on or before 31 May, an amount equal to that debit balance. This is an amount of tax by way of further income tax, and may be used to offset a future income tax liability.

Where there is no future income tax liability, this amount is retained by the Commissioner as it represents tax in respect of which credits have already been allocated to shareholders.

If this amount is not paid by the due date, the standard six-monthly incremental penalty at the rate of 10% will be incurred. Where the ICA is in debit at the end of the imputation year, imputation penalty tax is also payable (refer to the discussion on section 394N below).

The Commissioner has power to assess the tax, and the taxpayer may object to the assessment in the usual way.

#### **Section 394M - Limits on refunds of tax**

In order to protect the revenue, the amount of credits attached to dividends in each imputation year should not exceed the credits in the ICA (after taking into account further income tax) as at the end of the imputation year.

Where a company allocates credits in year 1 and in year 2 is entitled to a refund of income tax paid in year 1, the Commissioner would, if the company has a nil or debit balance in its ICA, effectively be refunding an amount which has already been passed on by way of credit to shareholders.

Section 394M therefore imposes a limit on the amount of income tax which may be refunded to an ICA company. The amount to be refunded shall not exceed the credit balance in the ICA as at the previous 31 March. Any excess which is not refunded may be offset against a future income tax liability. Where there is no future income tax liability, the Commissioner will retain that amount.

In this situation there is a debit entry in the ICA of the cash amount refunded to the company. There is no debit entry for the amount retained by the Commissioner.



### Example

	Dr	ICA	Bal
	\$	\$	\$
7 July 1989		5,000	5,000
7 November 1989	5,000		0,000
7 March 1990		5,000	5,000
15 March 1990	13,000		
31 March 1990			2,000
3 September 1990 - refund owing	3,000	2,000	

The refund to the company is limited to \$2,000 which is the amount of the debit entry in the ICA. The other \$1,000 is retained by the Commissioner and can be credited against payment of provisional tax due in November 1990 or any subsequent income tax liability.

Where there are two refunds paid in an imputation year, the amount of the credit balance in the ICA at the end of the previous imputation year is reduced for the purposes of calculating the amount of the second refund by the amount of the first refund. The reference in section 394M(3) to dividend withholding payment is of relevance where a company has no dividend withholding payment account and dividend withholding payments and refunds thereof are entered in the ICA.

### Section 394N - Imputation penalty tax

Where a company is in debit at the end of an imputation year imputation penalty tax is payable in addition to further income tax. Imputation penalty tax is intended to be a disincentive for a company to be in debit at year end. It is not a penalty for late payment of tax.

The amount payable is 10 percent of the amount of further income tax payable (in other words, 10 percent of the debit balance at 31 March) and is due by the following 31 May.

There are the standard late payment penalty provisions in the event that the imputation penalty tax is not paid by due date. As with further income tax, the imputation penalty may be assessed and a company can object to such an assessment in the normal way.

### Sections 394Q to 394ZB - Statutory Producer Boards and Co-operative companies

These provisions are covered on pages 15 to 18.

### Section 394ZC - Income to include credits

Where a shareholder receives a dividend with an imputation credit, or dividend withholding payment credit, attached, the shareholder must return the amount of the credit plus the amount of the dividend as assessable income (unless the shareholder is exempt from tax on dividends).

For example, if there is a dividend paid of \$1,000 to which \$250 credits have been attached, \$1,250 is included as assessable income and \$250 claimed as a credit. The only exception to this is a notional distribution made by a producer board or co-operative company - refer to section 394ZC(2) and the commentary on page 16).

Section 394ZC(3) and (4) merely retain the provisions previously in effect and contained in repealed section 4(6) and (7) relating to the assessability of foreign imputation credits to which New Zealand residents are beneficially entitled under double tax treaties.

### Section 394ZD - Amount of credit

This section limits the amount of credit to be allowed by the Commissioner in certain circumstances.

## 1. Trusts

### Beneficiary income

In order to prevent the streaming of credits by trustees the amount of credit which will be allowed to a beneficiary who derives dividends with an imputation credit (or dividend withholding payment credit) attached is calculated in accordance with this formula:

$$a \times \frac{b}{c}$$

where

a = all imputation and dividend withholding payment credits attached to dividends distributed to beneficiaries during the year

b = all distributions (income and capital) made to the beneficiary during the year

c = all distributions (income and capital) made to beneficiaries of the trust during the income year

Effectively the amount of credit which will be allowed to each beneficiary is proportional to the distributions made to them during the year.

### Example

Beneficiaries of Trust: A and B

A receives all dividend income (\$10,000 with \$2,800 credits attached)

B receives all interest income (\$12,000)

The amount of credit which be allowed to A is

$$\$2,800 \times \frac{\$10,000}{\$22,000} = 1,272.73$$

The remaining credits will be lost.

### Trustee income

Where the dividends are retained by the trustee and taxed as trustee's income, the imputation credits are included in the assessable income of the trustee and allowable as a credit against the trustee's tax liability.

As group investment funds in so far as they derive category A income are treated as companies, the formula in section 394ZD(1)(a) which restricts the amount of credit which may be claimed by a beneficiary of a trust does not apply to group investment funds in so far as a beneficiary derives category A income (s394ZD(2))

## 2. Partnerships

There is a similar rule applying to partnerships. Where a partnership has derived dividend income with imputation credits (or withholding payment credits) attached, the amount of credit which will be allowed to a partner under section 394ZD(1) will be:

$$a \times \frac{b}{c}$$

where a = the total of imputation and dividend withholding payment credits attached to received by the partners in an income year

b = the partner's share of the partnership income in that year

c = the income of the partnership for the income year

### Example

Partners A and B

Partnership receives \$5,000 dividend income (\$1,000 credits attached)  
\$11,000 other income

If the income is split equally, the amount of credit allowed to both A and B will be

$$\$1,000 \times \frac{8,000}{16,000} = 500$$

If, however,

A receives \$8,000 income (including all dividend income)

B receives \$8,000 income

The amount of credit allowed to A will be  $1,000 \times \frac{8,000}{16,000} = 500$

B will receive no credits (as he derived no dividend income). Therefore \$500 of the credits are not available for use.

### 3. Exceeding imputation ratio - section 394ZD(1)(c), (d) and (e)

Where a company attaches imputation (or dividend withholding payment credits) to a dividend at a higher ratio than is permitted, the amount of the credit allowed will be the amount calculated at the maximum ratio permitted (section 394ZD(1)(c) and (d)). For imputation credits the maximum ratio permitted is set out in section 394G (refer to page 6) while for dividend withholding payment credits the maximum ratio is set out in section 394ZY (refer to page 24).

Where both types of credit are attached, the combined ratio also must not exceed

$$\frac{\text{company tax rate}}{1 - \text{company tax rate}}$$

Where it does, there is a formula in subsection (5) of section 394ZD for disallowing the excess credit. Firstly the dividend withholding payment credit is reduced in so far as it extends, then, if there is still an excess credit, the imputation credit is reduced.

### 4. Failure to furnish shareholder dividend statement - section 394ZD(1)(f) and (g)

In order to obtain a tax credit for imputation or dividend withholding payment credits attached to a dividend, the shareholder is required to file the shareholder dividend statement (or other evidence in writing of the credit) with the shareholder's income tax return. Where the statement or other evidence is not filed the Commissioner will not allow the shareholder a credit of tax.

### 5. Insufficient tax paid - section 394ZD(1)(h) and (i)

Where a company has attached an imputation credit and has not paid sufficient tax or further income tax, the Commissioner may disallow part of the credit of tax.

As noted earlier, a company may during an imputation year attach credits for tax which it has not at that time paid. However, if it has not paid such tax by 31 March it must pay "further income tax" by 31 May (refer to page 8 above). Where the further income tax is not paid, the Commissioner may disallow credits attached to a dividend in that year.

Where the tax is subsequently paid by the company, the Commissioner has power to reinstate credits (section 394ZE(6)).

Similar rules apply where a company has attached dividend withholding payment credits to a dividend and the company has not paid sufficient dividend withholding payments.

### 6. Credit in excess of proper amount - section 394ZD(1)(h) and (i)

Where the imputation credit or dividend withholding payment credit claimed by a shareholder is in excess of the proper amount, the Commissioner will not allow the claim to the extent of the excess. There is no definition of what constitutes an amount in excess of the proper amount but this would, for example, be where a shareholder has fraudulently altered the shareholder dividend statement so that it shows a higher credit than that attached to the dividend.

### 7. Stapled stock - section 394ZD(1)(j)

There is an explanation of section 394ZF, which covers stapled stock on page 20. Briefly, where a company (company A) which cannot operate an ICA and pass credits to shareholders enters into a stapled stock arrangement so that its shareholders may receive credits from another company (company B), no credit of tax will be allowed for any credit attached to a dividend paid by company B to the shareholders of company A

## 8. Arrangement to obtain a tax advantage - 394ZD(1)(k) and (l)

Where a shareholder has entered into a shareholder tax advantage arrangement, there is power in section 394ZG (refer to page 21 for an explanation of that provision) for the Commissioner to determine the amount of imputation or dividend withholding payment credit which is the subject of the arrangement. No credit of tax is allowable in respect of that amount.

### **Section 394ZE - Credit of Tax**

Where the assessable income of a taxpayer includes the amount of an imputation credit, the taxpayer may claim a credit of tax of an amount equal to the credit. Generally companies receiving dividends with imputation credits attached will therefore not claim a credit of tax but will enter the amount of the credits in the ICA. However, where a company is assessed on dividend income, e.g. a life insurance company, the company itself may claim a credit.

As non-residents and tax-exempt bodies do not include the amount of a dividend in assessable income imputation credits do not give rise to a credit of tax in the hands of non-residents and tax-exempt bodies. This is in contrast to dividend withholding payment credits which do give rise to a credit of tax in the hands of non-residents and tax exempt bodies.

There will be no refund of any unutilised imputation credits, but in order to enable the taxpayer to effectively carry forward the excess credits, those credits are converted into a loss which is carried forward to the succeeding income year of the taxpayer

The amount of the loss which is to be carried forward is calculated using the formula in section 394ZE(3)(b) - i.e

$$\frac{a}{b} \quad \text{where}$$

a = the amount of unutilised imputation credits

b = the extra emolument tax rate (for the income year in which the dividend is included in assessable income).

### **Example**

1989 income year		\$
Income from employment	2,000	
Dividend Income	27,700	(includes credits)
Credits attached	(7,700)	
Total income	29,700	
Tax payable (at, say, .24)	7,128	
Imputation credits	7,700	
Tax Payable	Nil	
Excess credits	572	- converted to loss c/f
PAYE paid	480	- refunded
Amount of Loss carried forward -	$\frac{572}{28}$	= 2,043

Note: Non-refundable credits are to be claimed before refundable credits. In the above example, therefore, PAYE credits are claimed after imputation credits. This is to give the taxpayer maximum benefit of the credit.

### **Section 394ZF - Stapled stock**

There are businesses which pay New Zealand income tax but which are not permitted to operate an ICA and attach credits to dividends - for example a branch of a non-resident company. Where the non-resident company has New Zealand shareholders, it may nevertheless want to pass on credit to those shareholders for New Zealand tax paid. It is possible to enter an arrangement whereby that non-resident company sets up a company in New Zealand and gives to its shareholders shares which are "stapled" to shares in the non-resident company. Such shares are "stapled" because they are allocated on the basis of shareholding in the non-resident company and may be disposed of only with those shares.

An alternative arrangement is where the New Zealand company pays dividends to shareholders in the non-resident company by virtue of their shareholding in the non-resident company.

Dividends may then be paid from the New Zealand company and imputation credits attached to the dividends.

Section 394ZF is intended to remove any incentive for companies to staple stock for this purpose. Where dividends with credits attached are paid by a resident company, as part of a stapled stock arrangement, those credits do not give rise to a credit of tax.

(Neither do they form part of assessable income of the shareholder.) There is no provision for a credit entry reversing the debit which arose on attachment of credits in the ICA of the company paying the dividend.

It is anticipated that the type of company which will institute such an arrangement will not be able to operate an ICA. Generally therefore subsection (2)(c) will be of no effect.

### **Section 394ZG - Tax Advantage arrangements**

This section has two purposes:

1. to prevent shareholders buying and selling shares in order to pass imputation (and dividend withholding payment) credits to those best able to use them, and
2. to prevent companies "streaming" credits to those shareholders best able to use them.

The rationale for these anti-streaming provisions is that all shareholders have borne the company tax and the credits should be allocated to them all in proportion to their shareholding. In addition, if streaming is permitted, there is a greater cost to the Revenue in imputation.

#### **1. Transfer of shares**

There is deemed to be an arrangement to obtain a tax advantage where

- (i) there is an arrangement for the sale of shares and
- (ii) the vendor or purchaser anticipates that a dividend with an imputation credit or dividend withholding payment credit attached would be paid in respect of the shares and
- (iii) the vendor or purchaser might expect that one of them will, and the other will not, be able to obtain a credit of tax in respect of the imputation or dividend withholding payment credits.

The purpose of the arrangement to transfer the shares must be to enable the vendor or purchaser to obtain the credit of tax.

#### **Example**

Shareholder A - resident  
Shareholder B - non-resident

Shareholder B, as a non-resident, cannot obtain a tax advantage (defined as including the allowance of a credit of tax under section 394ZE) because dividends received by B, although subject to non-resident withholding tax, are not included in his assessable income in New Zealand. It may therefore be in the interests of A and B to transfer the shares prior to payment of a dividend with credits attached for the purpose of enabling A to obtain the benefit of credits attached to the dividend which would have been paid to B.

Where this occurs, the Commissioner may determine that the arrangement is a shareholder tax advantage arrangement - i.e. an arrangement which relates to the obtaining of an allowance of a tax credit - and the amount of the credit which is the subject of the arrangement.

So, in the above example if B transferred his share to A prior to payment of a dividend with a credit attached, and A therefore received in relation to each share \$72 net dividend with \$28 imputation credits attached, the Commissioner would determine that \$28 was the subject of the arrangement.

Under subsection (6) Shareholder A is not entitled to a credit of tax for that \$28.

#### **2. Streaming of imputation (and dividend withholding payment) credits**

Under sub-section 2(b) where a company streams the payment of dividends or the attachment of credits to those shareholders who can benefit from the receipt of credits the Commissioner has the powers set out in subsection (4).

The principle may be illustrated in two examples.

##### **1 Example 1**

Shareholder A - resident  
Shareholder B - non-resident

A company with the above shareholders wishes to stream credits so that shareholder A receives all imputation credits (shareholder B receives payment in lieu of credits).

In June 1990 the company pays dividends to A and B - the dividend to A carries the maximum credits and the dividend to B carries no credits. The company has, in terms of subsection (2)(b), streamed the attachment of imputation credits in such a way as will give a higher credit value to A (being a shareholder who will obtain a tax advantage from imputation credits) than to B (who will not obtain a tax advantage from credits).

Section 394ZG(3) sets out a variety of circumstances where a dividend is deemed to have a higher credit value. For example, a dividend has a higher credit value than another dividend when -

- the dividend has an imputation credit attached and the other dividend does not,
- the imputation ratio of the dividend is higher than that of the other dividend.

Therefore in this example there is an arrangement to obtain a tax advantage. In exercising his powers under subsection (4), the Commissioner may determine, in relation to the above example:

(a) That the arrangement is a shareholder tax advantage arrangement as the arrangement relates to the obtaining of a credit of tax under section 394ZE: (if the shareholders are both companies, it will be a "company tax advantage" arrangement);

(b) that there should arise in the ICA of the company a further debit;

(c) that the amount of the imputation credit which is the subject of the arrangement is \$28, being the amount of credit which should have been attached to the dividend to B so that all dividends were credited equally during the imputation year,

(d) that the arrangement occurred in the imputation year ending on March 31, 1991.

When the Commissioner has so determined, then a further debit of \$28 arises in the ICA of the company at the end of the imputation year in which the arrangement occurred.

#### Example 2

Shareholder A - resident  
Shareholder B - tax-exempt

A company with the above shareholders pays a \$720 dividend in the 1990 imputation year to shareholder A only with \$280 credits attached. In the 1991 imputation year it pays an uncredited dividend to shareholder B only. In 1992 the company pays to A a further \$720 dividend with \$280 credits attached.

The company has in this example "streamed the payment of dividends" and "the attachment of credits" "over more than one imputation year" "in such a way as will give higher credit values to shareholders who will obtain a tax advantage therefrom than to shareholders who will not so obtain a tax advantage".

The dividend paid to A has a higher credit value than the dividend paid to B because the dividend paid to A had an imputation credit attached and the other did not.

It is not possible to avoid the application of subsection (2)(b) by crediting the dividend to B at a lower rate than the dividend to A. In that circumstance, the imputation ratio of the dividend to A is higher than that of the dividend to B. The dividend therefore has a higher credit value (subsection (3)(b)).

As with example 1, this is therefore an arrangement to obtain a tax advantage and the Commissioner may determine:

- (a) that it is a shareholder tax advantage arrangement
- (b) that there should arise a debit in the ICA of the company
- (c) the amount of the credit which is the subject of the arrangement is \$280
- (d) the arrangement occurred in 1991.

A further debit of \$280 will arise to the ICA of the company at the end of the 1991 imputation year (see section 394E(1)(h)).

The Commissioner is required to advise the company of the determination he makes under subsection (4).

#### **Section 394ZH - Credits and Debits incorrectly recorded**

The Commissioner may, either on investigation of a company or following receipt of the annual imputation return, check the entries recorded in the ICA. Where the Commissioner considers that

- an incorrect amount has been recorded, or
- a date of an entry is not correct or
- there is an entry omitted from the ICA

the Commissioner may determine the correct amount and date of the entry as appropriate.

Where he does so the amount is to be recorded in the ICA of the company along with any necessary corrections made as a result of the Commissioner's determination. Any such amount is to be recorded in the ICA with effect from the date the original credit or debit arose or is determined to have arisen.

The company may object to the notice of determination.

### **Sections 394ZI and 394ZJ - Transitional**

#### **1. Credit for provisional tax paid before 16 December 1988**

A credit arises in the ICA for provisional tax and income tax paid by the company for the 1989 and subsequent income years. Early balancing companies will have paid provisional tax prior to 1 April 1988 - where this occurs the credit arises on 1 April 1988.

Payments of provisional and income tax for the 1989 year which are made prior to the enactment of the legislation (16 December 1988) are credited to the ICA on the date of payment.

#### **2. Dividends paid before 1 February 1989**

A company may, prior to 31 March 1989, determine that an imputation credit will be retrospectively attached to a dividend or dividends paid between 1 April 1988 and 31 January 1989.

Where the company so determines, it must

- (a) Debit the ICA, as at the date of payment of the dividend, with the amount of the credit attached
- (b) Complete the company dividend statement at the time it makes the determination, and
- (c) Give to the shareholder a shareholder dividend statement at the time it makes the determination.

The allocation rules apply in the first year in the same way as they do for any other year. Therefore if a company determines to retrospectively attach credits to a dividend, it must attach credits at the same imputation ratio to all dividends paid during the imputation year ending on 31 March 1989. It may, however, complete a ratio change declaration in accordance with section 394G. Section 394J requires this to be filed by 31 March 1989 (this date was originally 7 February 1989 but the date was amended in the Income Tax Amendment Act 1989).

Where, of course, a company would not have been an ICA company at the time it paid the dividend, it is not permitted to retrospectively credit the dividend.

### **Sections 394Q to 394V - Statutory Producer Boards**

Statutory producer boards are now liable for income tax (refer to Technical Policy Circular 89/2 Part II) and dividend withholding payment on foreign source dividends.

As statutory producer boards do not have conventional shareholding structures, special provision must be made to enable them to impute to their members credits for income tax (and dividend withholding payment) paid by them.

**Statutory producer board** is defined in section 394Q and basically means any primary producer or marketing board established by an Act.

A **member** of a board is defined as any person resident in New Zealand who, during an income year in question, carries on any farming or agricultural or other business and who is liable to pay a levy to the board, or who supplies produce to the board, during the year.

A statutory producer board is deemed to be a company for the purposes of the Act and is therefore required to maintain an ICA for each imputation year. Credits and debits arise to the account as they do for other companies under sections 394D and 394E of the Act.

Under section 394R a statutory producer board can distribute credits to members in one of two ways - by means of

1. a notional dividend
2. a cash dividend

A determination to do so must be made within 6 months after the year of determination in respect of which the determination is made (section 394R(3)). A "year of determination" is defined as an income year that commences on or after 1 April 1988.

## 1. Notional dividend

The producer board may allocate imputation credits to members on the basis of

- (a) the proportion of produce transactions of the member to all produce transactions during the year of determination, or
- (b) the proportion of levies which a member paid to the amount of levies paid by all members, or
- (c) a combination of (a) and (b), or
- (d) any other method approved by the Commissioner.

In relation to paragraph (d) above, the Commissioner will approve an alternative method of allocation on a case by case basis upon application by a producer board.

Section 394T provides the respective formulae for allocation of credits to be attached to a notional distribution in relation to a member of the board on the basis of produce transactions of a member or levies paid by a member.

The Commissioner has power to determine the extent to which a board should have made the calculation on another basis if he considers that a calculation made by a board does not result in a fair and reasonable allocation - section 394T(4).

### Example - (a) allocation on basis of produce transactions

Producer Board with two members:

A - \$1,000 of produce transactions during year ending 30 June 1990

B - \$2,000 of produce transactions during year ending 30 June 1990

Formula in section 394T(2)

$$\frac{a}{b} \times c$$

a = amount paid to or by the member for produce transactions during the year

b = amount paid to or by all members for produce transactions during the year

c = all imputation credits which the producer board has determined to attach to the notional distribution

If the producer board has \$1,500 credits in its ICA which it wishes to allocate to members, it calculates the amount of credit to be allocated to each member as follows:

$$A \quad \frac{1,000}{3,000} \times 1,500 = 500$$

$$B \quad \frac{2,000}{3,000} \times 1,500 = 1,000$$

Where the producer board determines to attach a credit to a notional dividend, it is deemed to have paid a dividend to each member of the following amount:

$$\frac{a}{b}$$

where a = the amount of imputation credit attached

b = the resident companies' tax rate (for the income year in which the determination is made)

So, in the example above, on the basis of a company tax rate of 28%, the notional dividend paid to member A would be

$$\frac{500}{28} = \$1,785.71$$

Member A will therefore receive a "notional" dividend of \$1,785.71 with 500 credits attached - this is a dividend carrying the maximum imputation ratio. (As all notional dividends will be fully credited the allocation rules in section 394G do not apply to producer boards.)



A will receive no cash (hence the term “notional” dividend), merely a shareholder dividend statement. The dividend is derived on the date of the determination by the producer board and must be included in the member’s assessable income for that year.

Note: In all circumstances other than the receipt of a notional dividend, a non-corporate shareholder returns as assessable income the dividend received plus the imputation credit attached. In the case of a notional dividend, the amount of the notional dividend already includes the credit. Imputation credits attached to notional dividends are therefore not added to the notional dividend paid in returning assessable income. Member A will return \$1,785.71 as income and claim \$500 credits.

As noted earlier, this is a means of allowing imputation credits for tax paid by the producer board to flow through to the member. If member A is on a tax rate which is higher than the company tax rate he/she will receive no cash and will be required to pay additional tax on that notional dividend. For those on the company tax rate, or a lower rate, there will be no additional liability.

When the cash which was represented by that notional dividend is subsequently distributed, it is distributed tax-free to members (section 4A(1)(j)) - this is because, of course, tax has already been assessed to a member on that amount. However, the amount which is paid to the member cannot be an amount which is deductible to the producer board - section 4A(5) deems such a distribution to be a return of capital for the purposes of section 106(1)(a) which prohibits a deduction for capital. Producer boards are required to keep sufficient records to enable the Commissioner to determine whether an amount which is distributed is an amount which was represented by a notional distribution.

Producer boards are not required to file company dividend statements but section 394U(3) requires that they furnish with the annual income tax return particulars of the dividend deemed to have been paid.

## 2. Cash Distributions

The second method which a producer board may adopt for passing on imputation or dividend withholding payment credits to members is to attach the credits to a cash distribution which would have been deductible to the board but which the board has elected to treat as non-deductible. (To allow a company to attach imputation credits to an amount which is deductible is effectively to allow credit for tax not paid.)

The amount of the distribution which the producer board elects to treat as non-deductible is deemed for the purposes of the Act to be a dividend. It will be derived by the member when it is received.

The producer board may elect to make a cash distribution to all who were members at any time during year X based on:

- (i) the proportion of a member’s produce transactions with the board to the total produce transactions, or
- (ii) the proportion that levies payable by each member bear to the total levies payable by all members of the board, or
- (iii) any other method approved by the Commissioner.

The formula for calculating the amount of imputation credits which may be attached to a cash distribution is set out in section 394S:

$$a \times \frac{b}{1 - b}$$

where a = the amount of the cash distribution

b = the resident companies’ tax rate (for the year in which the determination is made)

### Example

In July 1989 a producer board wishes to allocate credits to a total cash distribution of \$900 made to members of the producer board during the year ended 30 June 1989. The cash distribution would have been deductible under the Income Tax Act but the producer board elects to treat this amount as non-deductible in determining its assessable income.

The amount of credits which may be attached to the distribution (on the basis of a company tax rate of 28%) is

$$900 \times \frac{.28}{.72} = 350$$

Member A in that year was paid \$1,000 in produce transactions

Member B in that year was paid \$2,000 in produce transactions

Member A is to receive \$600

Member B is to receive \$300

The amount of credit to be allocated to each member is calculated according to the formula in section 394S(2):

$$\frac{c}{d} \times e$$

Where c = the member's share of the cash distribution

d = the total amount of the cash distribution

e = the amount of imputation credits attached in respect of the cash distribution

Member A therefore receives  $\frac{600}{900} \times 350 = 233.33$

A receives a \$600 cash distribution with \$233.33 credits attached

S/he will return \$833.33 (distribution plus credits) as assessable income and claim \$233.33 credit of tax.

Member B receives  $\frac{300}{900} \times 350 = 116.66$

B receives a \$300 cash distribution with \$116.66 credits attached.

S/he will return as income \$416.66 and claim a credit of \$116.66.

### **Section 394W to 394ZB - Co-operative companies**

There are provisions for co-operative companies which parallel sections 394Q to 394V applying to producer boards.

In addition to being able to allocate credits to members by attaching them to notional distributions and cash distributions, co-operative companies which are imputation credit account companies and dividend withholding payment account companies may pay dividends and attach credits thereto in the normal way.

In relation to allocation rules, these apply only to attachment of credits to those dividends which are not notional distributions or cash distributions, i.e. dividends which are paid in proportion to shareholding in, rather than transactions with, the co-operative company. As with producer boards, notional and cash distributions are fully credited.

The other difference is that co-operative companies are only entitled once in respect of each year of determination to attach a credit to a notional distribution and/or a cash distribution.

## **PART B : DIVIDEND WITHHOLDING PAYMENT REGIME - FOREIGN SOURCE DIVIDENDS**

The dividend withholding payment regime is contained in Part XIIB of The Act and is in two parts - dividend withholding payments and dividend withholding payment accounts. It was introduced in order to counter deferral of tax on foreign source dividends. It is not a tax on the company: the company deducts and pays the withholding payment on behalf of the shareholder.

### **A. DIVIDEND WITHHOLDING PAYMENTS**

#### **Section 394ZK- Interpretation**

This section provides various definitions for the purpose of the withholding payment regime. There is comment upon relevant definitions where these are used in the substantive sections.

#### **Section 394ZL - Deduction in respect of foreign withholding payment dividend**

In broad terms, where a company resident in New Zealand is paid a dividend from a non-resident company on or after 1 April 1988, it is required to deduct an amount of dividend withholding payment (DWP) from that dividend.

"Paid" is defined for the purposes of Part XIIB of the Act and includes "...distributed, credited, or dealt with in the interest of or on behalf of ...". Liability to make DWP arises when the dividend is paid by the foreign company and not when that dividend is received.

Section 394ZL(2) sets out in detail the type of dividends in respect of which a deduction is to be made. It applies to dividends received which are exempt from tax under section 63 of the Act and which are

- (a) paid by a non-resident company or
- (b) paid by a resident company which is not subject to tax on part or all of its income under a double taxation agreement or
- (c) paid by a resident company where the company previously was not resident and had, prior to becoming resident, more funds available for distribution than the amount of the dividend. This is to prevent overseas companies changing residence to New Zealand and then paying dividends from sums accumulated overseas.

These dividends are referred to as "foreign withholding payment dividends, or "foreign dividends".

The restricted definition of dividends which applies for the purpose of attaching imputation and dividend withholding payment credits to dividends does not apply in determining which dividends are subject to the dividend withholding payment deduction (see section 394ZK(2)).

#### **Section 394ZM - Dividend withholding payment to be deducted**

##### **1. Amount to be deducted**

The formula for calculating the amount to be deducted from a foreign dividend is set out in subsection (1) -

$$(a \times b) - c$$

where a = the amount of the foreign dividend paid including any foreign withholding tax (FWT) deducted from that dividend

b = the rate of resident companies' income tax for the income year in which the dividend is received

c = the amount of foreign withholding tax (not exceeding a x b)

The amount of DWP payable is reduced by any FWT that has been deducted. For this purpose the Advance Corporation Tax (ACT) payable in the United Kingdom is not regarded as FWT.

##### **Example**

Dividend received in March 1989 of \$100 gross (consisting of \$85 cash and \$15 FWT deducted)

Amount of DWP to be deducted:  $(100 \times .28) - 15 = 13$

If the dividend was received on or after 1 April 1989, then the amount of DWP would be:  $(100 \times .33) - 15 = 18$

The formula can at most give a Nil result and never a negative amount. So that if \$100 gross (\$30 FWT deducted) is received the amount to be deducted is:  $(100 \times .28) - 28 = 0$

for a dividend paid on or before 31 March 1989. If the dividend was paid on or after 1 April 1989, the DWP to be deducted would be:  $(100 \times .33) - 30 = 3$

If a company which receives foreign dividends is a Branch Equivalent Tax Account company, refer to paragraph 2 below.

## **2. Branch Equivalent Tax Account (BETA) Company**

The branch equivalent tax regime is referred to in detail in Part C of this Commentary. However, for the purposes of section 394ZM it is sufficient to say that a company which has an income interest in a controlled foreign corporation (CFC) under the international tax regime may operate a branch equivalent tax account. The purpose of operating the account is to prevent double taxation of income - once under the branch equivalent tax regime and also through the dividend withholding payment regime, when dividends are distributed from the CFC to the New Zealand company. Tax paid under the CFC tax regime is a credit to the BETA.

Under section 394ZM(2) where a company which operates a BETA is paid a dividend in respect of an income interest in a CFC, the amount to be deducted as dividend withholding payment can be reduced by an amount of up to the credit balance in its BETA at the time the foreign dividend is paid (see section 394ZZQ(3)). When a dividend withholding payment is reduced in this manner, the amount of the reduction is debited to BETA and there is no entry in the dividend withholding payment account.

### Example

Company is paid in April 1989 gross dividend of \$100 (15% NRWT deducted)  
DWP payable =  $(\$100 \times .33) - 15 = \$18$

If the company has a credit balance of at least \$18 in its BETA at the time the dividend is paid by the CFC, it may use this to satisfy payment of DWP.

There arises a debit to BETA of \$18. A credit of \$18 simultaneously arises in the company's ICA (section 394D(1)(i)).

Subsection (3) of section 394ZM sets out in detail in what circumstances a dividend paid to a company is deemed to have been paid in respect of an income interest in a CFC. This is basically where the company held the interest in the CFC -

- (i) during the income year before the year in which the dividend was paid, or
- (ii) between the beginning of the income year in which the dividend was paid and the date of payment of the dividend.

Under subsection (4) evidence of payment of foreign withholding tax that reduces the DWP deduction is required to be furnished to the Commissioner having regard to the time period stated in section 301 of the Act.

### **Section 394ZN - Payment of Dividend Withholding Payment**

A company which is liable to make a deduction on receipt of a foreign dividend is required to pay the amount of the deduction on a quarterly basis. Companies which have received foreign dividends during a quarter are required to pay the amount of the deductions made to the Commissioner within 14 days of the end of the quarter. "Quarter" is a defined term and is the period ending with the last day of March, June, September and December in each year. Payments are therefore due on 14th January, April, July and October in each year.

### **Companies in loss**

There is provision in subsection (2) for companies in a tax loss position to reduce the loss carried forward in lieu of paying the dividend withholding payment on foreign dividends.

There are two circumstances in which a company may reduce its loss:

- (a) Where a company has incurred a loss in a previous income year which may be set off against income derived during the year in which it received the foreign dividend, or
- (b) Where a company has reason to believe that it will incur a loss for the income year in which the dividend is received.

If it chooses to reduce its loss, the company must notify the Commissioner by the 14th of the month following the quarter in which the foreign source dividend was received (i.e. the standard payment date for DWP) of its election to reduce its loss in lieu of making the withholding payment. The formula for calculating the amount by which the loss is to be reduced is:

$$\frac{a}{b}$$

where a = the amount of dividend withholding payment payable  
b = the resident companies' tax rate (for the income year in which the dividend was received).

Under subsection (3), where the company elects to reduce a current year loss and the company does not incur a loss or does not incur a loss large enough to enable it to reduce the loss in satisfaction of a liability for dividend withholding payment, the

Commissioner has the power to disallow the election. The company is then required to pay the dividend withholding payment in respect of which the election has been disallowed plus late payment penalties. The penalty for late payment of dividend withholding payment is set out in subsection (4) and is the standard six-monthly incremental at 10%.

Subsection (5) provides that where a company fails to deduct DWP the amount of the DWP liability constitutes a debt payable to the Commissioner and is deemed to be payable within 14 days of the end of the quarter in which the initial liability arose.

Subsection (6) allows the Commissioner to recover an amount equal to the foreign withholding tax that reduced the amount of any DWP where evidence of the foreign withholding tax has not been furnished within the period required under section 394ZM(4).

The Commissioner has the powers of assessment referred to in subsection (7).

## **Section 394ZO - Refunds**

### **1. Restriction on amount of refund**

Where a company has overpaid dividend withholding payment, it is entitled to a refund. However, there are similar restrictions on refunds as apply to refunds of income tax to an ICA company.

Where during imputation year X a company becomes entitled to a refund of dividend withholding payment paid in year X-1 (i.e. the previous imputation year), the refund is not to exceed:

(a) the amount of the credit balance in the dividend withholding payment account (DWPA) at the end of year X-1

(b) where the company has no DWPA, the credit balance in the ICA at the end of year X-1.

Where the company which is entitled to a refund has ceased to be resident in New Zealand, the refund cannot exceed the amount of the credit balance that was debited in the DWPA or ICA immediately before the company became non-resident (that is the amount debited under sections 394ZW(1)(g) and 394E(1)(i)).

The amount of any credit balance in the DWPA or ICA available at the end of year X-1 is reduced by the amount of any previous refund of DWP or income tax (as appropriate) in year X.

### **2. Refunds to company in loss**

Where a company that has paid dividend withholding payment in income year X incurs a loss in that year and has filed a return for that year, the company is entitled to a refund of the lesser of:

(a) the amount of dividend withholding payment paid during year X, or

(b)  $a \times b$

where  $a$  = the amount of the loss

$b$  = the resident company tax rate for year X, or

(c) the amount of the credit in the DWPA at the end of the previous imputation year.

#### **Example**

A company in the imputation year ended March 1990 pays DWP of \$1000. It incurs a loss of \$2,000 for the 1990 income year and has a \$500 credit balance in its DWPA at 31 March 1990.

It will receive a refund of the lesser of:

(a) \$1,000

(b)  $\$2,000 \times .33 = \$660$

(c) \$500

Where a company is paid a refund of DWP because it has a tax loss, the amount of the company's loss is reduced by an amount calculated in accordance with the following formula:

$$\frac{a}{b}$$

where a = the refund paid to the company

b = the resident companies tax rate

Where the Commissioner does refund an amount of DWP in excess of the proper amount, he may recover the excess as if it were income tax payable by the company.

**Section 394ZP - Credit of tax for dividend withholding payment (DWP) credit**

This provision parallels section 394ZE in relation to imputation credits. Where the assessable income of a taxpayer includes the amount of a DWP credit, the taxpayer obtains a credit of tax equal to the amount included.

The credit of tax is credited in payment of income tax payable in respect of the income year in which the dividend is paid to the recipient and the **excess is refundable**. In this respect a DWP credit differs from an imputation credit.

As the DWP credit is refundable, it is credited to income tax payable after non-refundable credits such as imputation credits and credits for overseas tax.

The shareholder must, in order to obtain the credit of tax, furnish the shareholder dividend statement or other written evidence of the DWP credit.

Where a company has paid insufficient DWP, or further DWP, to support the credits which it has allocated during a year the Commissioner has power to disallow the credits. If the DWP is subsequently paid, the Commissioner may reinstate the credits.

As provided in the imputation regime, subsections (6), (7) and (8) provide the Commissioner with the power to disallow DWP credits and recover refunds where a taxpayer has claimed DWP credits in excess of the proper amount.

Section 394ZD applies also to DWP credits. The amount of DWP credit which the shareholder may claim can be restricted in certain circumstances (refer to page 16 of this commentary).

**Section 394ZO - Refunds to non-residents and tax exempts**

As noted above, unutilised DWP credits are refundable. This section provides the mechanism of refund to the two groups of shareholders who do not ordinarily file income tax returns.

Where a non-resident shareholder receives DWP credits attached to a dividend, these credits are automatically applied to satisfy liability for non-resident withholding tax on the dividend. The shareholder may apply for a refund of any surplus credits after 31 May following the end of the imputation year in which the dividend was received.

<u>Example</u>	\$
Cash dividend paid	720
DWP credits attached	<u>280</u>
Gross dividend	<u>1,000</u>
NRWT (15%)	150
DWP credits	<u>(280)</u>
DWP credits refund	<u>130</u>
Amount received by non-resident shareholder:	
Cash dividend	720
Credits refunded	<u>130</u>
	850

For a non-resident the position is the same as if a dividend of \$1,000 had been paid with 15% NRWT deducted - the non-resident would receive cash of \$850.

The company makes no payment of NRWT (see section 311(2)).

The \$280 credits have been used to satisfy the NRWT liability (\$150), the balance is refunded to the shareholder.

If the dividend was paid in, say, May or August 1989, the non-resident cannot apply to the Commissioner before 31 May 1990 for a refund. This delay is to enable the Commissioner to have the opportunity to confirm that payments of DWP have been made sufficient to support the credits allocated.

In order to obtain a refund the non-resident must forward the shareholder dividend statement or other evidence of the credit using, in the case of individuals, a form IR 3NR or an income tax return, to show details of all income derived from New Zealand during the relevant income year as well as the DWP credits attached to dividends.

A tax exempt shareholder or a non-resident corporate shareholder may apply for a refund by forwarding a written application or a company income tax return attaching the shareholder dividend statement or other evidence of the dividend withholding payment credit.

Any application by a non-resident for a refund of dividend withholding payment credit should be made to the

District Commissioner  
Inland Revenue Department  
Private Bag  
DUNEDIN

### **Section 394ZS - Offences**

This provision specifically makes it an offence to fail to deduct DWP or to fail to pay the same to the Commissioner. It is, however, under subsection (3) a defence to a charge of failure to pay that the amount of the deduction has been accounted for and the delay was due to accident or other cause beyond the control of the company.

## **2. DIVIDEND WITHHOLDING PAYMENT ACCOUNTS**

To a large extent the provisions relating to dividend withholding payment accounts (DWPAs) mirror those for the imputation credit accounts (ICAs).

It should be noted that there are several provisions which are contained in Part XIIA (relating to imputation credits) which apply to DWP credits - in particular sections 394ZD and 394ZG. Refer to the explanation of those sections on pages 9 and 13.

### **Section 394ZT - Election to maintain dividend withholding payment account**

It is not mandatory for a company to operate a DWPA - it may elect to do so by notifying the Commissioner that it has so elected within 21 days of the election or such further time as the Commissioner may allow. A company which operates a DWPA is a "dividend withholding payment account company" (refer to this definition in section 394ZK). The DWPA will run from the date of election for that and subsequent imputation years.

The advantage for companies in operating a DWPA is that they are able to attach DWP credits, which are refundable, to dividends paid. If therefore a company has non-resident or tax-exempt shareholders or shareholders on marginal tax rates lower than the company rate and is making dividend withholding payments or receiving dividends with DWP credits attached, it will be in the interests of those shareholders for the company to operate a DWPA. If it does not do so, entries which relate to the dividend withholding payment regime are made in the ICA and the resulting imputation credits will not be refundable.

A company may subsequently elect that it will cease to be an DWPA company. An election to cease to be a DWPA company will apply from the commencement of the imputation year succeeding the year in which the election to cease is made.

### **Section 394ZU - Dividend withholding payment account**

A company operating a DWPA is to record:

- the opening balance of the account in each year (as the account is operated for each imputation year, this will be done as at 1 April in each year) and
- debits and credits to the account as they arise under sections 394ZV and 394ZW.

### **Section 394ZV - Credits arising to the DWPA**

The following credits arise to the DWPA:

1. The amount of dividend withholding payment paid to the Commissioner. The credit arises on the date of payment. No credit will arise where a company elects, under section 394ZN, to reduce a loss in lieu of paying a dividend withholding payment.
2. The amount of a DWP credit attached to a dividend received by a company. This arises on the date the dividend was paid to the company.

3. The amount of 'further dividend withholding payment' paid to the Commissioner (refer to page 26 for an explanation of this). This is credited to the DWPA on the date of payment.
4. The amount of any previous debit to the DWPA which has arisen as a result of the Commissioner determining that there has been a tax advantage arrangement (refer to commentary on section 394ZG on page 13) and where it is subsequently established that there was no such arrangement. The credit arises on the date the previous debit arose.

#### **Section 394ZW - Debits arising to the DWPA**

The following debits arise to the DWPA:

1. The amount of DWP credits attached to a dividend paid by the company. This debit arises on the date that the dividend is paid.
2. Any part of the credit balance of the account at year end which the company elects to transfer to the ICA (refer to section 394ZZE). This arises at the end of the imputation year.
3. Any refund of dividend withholding payment. This arises on the date of payment of the refund.
4. The amount of any allocation deficit debit. The allocation rules in relation to the dividend withholding payment regime are similar to those for imputation - for a detailed explanation of the relevant provisions in section 394ZY see page 40. In brief, the DWP ratio (i.e. the DWP credit/net dividend paid) is to be the same for all dividends paid by the company during an imputation year. An allocation deficit debit arises on 31 March of the imputation year in which the company was in breach of the allocation rules.
5. Where there has been a tax advantage arrangement under section 394ZG, the amount which the Commissioner determines has been the subject of the arrangements. This arises at the end of the year in which the arrangement occurred or commenced.
6. Where the same persons cease to hold directly or indirectly 75% entitlement to the profits that may be distributed by the company, a debit arises at the time there ceases to be the required continuity of shareholding. See below for a detailed explanation of these provisions.
7. Where the company ceases to be a DWPA company a debit arises of the amount of the credit balance immediately before it ceases to be a DWPA company.

#### **Loss of Continuity**

Sections 394ZW(1)(f) and 394ZW(3) and (4) parallel sections 394E(1)(g) and 394E(3) and 394E(4) which apply the loss of continuity rules to companies which operate an ICA.

The problem which led to introduction of loss of continuity provisions in relation to the ICA - to prevent the sale of imputation credit trap companies - also applies to the DWPA.

The rules are the same as those detailed in relation to the ICA on page 6 of this commentary.

#### **Section 394ZX - Attachment of dividend withholding payment credit**

A DWPA company may attach a DWP credit to a dividend paid by the company. For this purpose, "dividend" does not in general include non-cash dividends or dividends for which a deduction is allowed under the Act (refer to the definition of "dividend" in section 394A).

A transitional provision provides for retrospective attachment of credits to a dividend paid during the period commencing 1 April 1988 and ending before 1 February 1989.

#### **Section 394ZY - Allocation rules**

Section 394ZY is a provision paralleling section 394G which relates to attachment of imputation credits (Refer to pages 10 and 11 for a detailed explanation of section 394G). References to imputation credits and imputation ratio should be read as dividend withholding payment credits and dividend withholding payment ratio (both of which are terms defined in section 394ZK).

Where a company is in breach of the allocation rules (i.e. where it has changed the dividend withholding payment ratio without filing a ratio change declaration) an allocation deficit debit arises to the DWPA. It is calculated in the same manner as the allocation deficit debit which arises to the ICA.

These allocation rules do not apply to notional and cash dividends paid by statutory producer board and co-operative companies - refer to page 15 for an explanation of the provisions which apply to those bodies.

#### **Section 394ZZ - Dividend with both imputation and withholding payment credits attached**

Where a company attaches to a dividend both imputation and withholding payment credits the combined imputation and dividend withholding payment ratio (defined in section 394ZK) is not to exceed



where a = the resident company tax rate for the income year.

For the year ending 31 March 1989 therefore, the combined ratio cannot exceed 28/72. With the recent change in the company tax rate to 33 cents from the 1990 income year the maximum ratio allowed will be 33/67 in respect of dividends paid on or after 1 April 1989.

Where a company attaches credits so that this ratio is exceeded there is a formula in subsection (2) for calculating those credits which are excess and will be disallowed. The excess credits will be disallowed in the manner provided in section 394ZD(5) (refer to the commentary thereon at page 18).

#### **Section 394ZZA - Company dividend statement**

Where a company which operates a DWPA attaches a DWP credit to a dividend, the company is to include the information listed in section 394ZZA in the company dividend statement which it completes at the time of declaring a dividend (refer to section 394H and the commentary thereon at page 9).

#### **Section 394ZZB - Shareholder Dividend Statement**

Where a DWPA company attaches a DWP credit to a dividend, it must at the time of payment either:

- (a) if it is attaching an imputation credit to the dividend and therefore is sending to the shareholder a shareholder dividend statement (see section 394I and commentary on page 7), include in the statement the information listed in subsection (1) relating to DWP credits;
- (b) if there is no imputation credit attached to the dividend, give to the shareholder a shareholder dividend statement in a form approved by the Commissioner setting out the details listed in section 394ZZB(2).

#### **Section 394ZZC - Annual dividend withholding payment account return**

Every DWPA company is required to give to the Commissioner by 31 May immediately following the end of each imputation year an annual dividend withholding payment account return. The return sets out the opening and closing balance of the DWPA together with the amount and source of all debits and credits that have arisen during the year.

In addition the following items should be included:

- The amount of further dividend withholding payment payable in respect of the imputation year;
- The amount of DWP penalty tax payable (this should be 100% of the amount of further dividend withholding payment)
- A statement showing whether the company has elected to cease being a DWPA company.
- The amount and source of all foreign withholding payment dividends paid to the company during the year and the amount of foreign withholding tax paid in respect of that dividend.

#### **Section 394ZZD - Dividend Withholding Payment Account Return Required upon Request or Cessation**

The Commissioner has power to require a company to file a DWPA return for any period.

Where a company becomes non-resident it must file a return for the period up to the date it became non-resident within 2 months of becoming non-resident.

Such returns are to contain the information listed in section 394ZZC in respect of the period to which the return relates.

#### **Section 394ZZE - Transfer of credit balance to ICA**

A company with a credit balance in its DWPA at year end (or a credit balance at the date it ceases to be resident) may transfer credits to the ICA. It may wish to do this in order to prevent the ICA from being in debit as at 31 March if it has allocated excess credits from its ICA during the year, and does not wish to pay an instalment of income tax or to pay further income tax at 31 March.

### **Section 394ZZF - Further dividend withholding payment payable**

This provision operates in the same way as section 394L which relates to further income tax payable in respect of an end of year debit in the ICA (refer to page 8).

A DWPA company may, during an imputation year, allocate credits to dividends in anticipation of credits subsequently rising to the DWPA. It may therefore be in debit at 31 March. Where this occurs, the company is required to pay an amount of "further dividend withholding payment" equal to the amount of debit balance in the account at 31 March. This must be paid to the Commissioner by the following 31 May.

The amount of further dividend withholding payment may be used to reduce payment of any DWP for which the company becomes liable after the date of payment of the further dividend withholding payment. Where, however, there is no further dividend withholding payment liability that amount is retained by the Commissioner. This is because the DWP credits have already been allocated to shareholders.

Where a company with a debit balance ceases to be resident, it is required to square up the DWPA before it ceases to be resident by a payment of further dividend withholding payment on the date it ceases to be resident. This may be one instance in which the further dividend withholding payment is retained by the Commissioner.

There are the standard late payment penalties applying to further dividend withholding payment.

The Commissioner has the power to assess the DWP and the company may object to the assessment in the normal way.

### **Section 394ZZG - Dividend withholding payment penalty tax**

Where a DWPA company is in debit at the end of an imputation year, and is liable for further dividend withholding payment, it will also be liable to pay dividend withholding payment penalty tax. This will be an amount equal to 10% of the debit balance in the WPA at 31 March. It is not a late payment penalty, but is intended to operate as a disincentive to companies being in debit at year end

The payment of DWP penalty tax is also due by 31 May following the end of the imputation year for which it is payable.

There are the standard late payment penalties applicable to payment of DWP penalty tax.

#### Example

	D W P A	
	D r	C r
April 1989		\$
May 1989	3,000	2,000
	_____	
Balance		
31 March 1990	1,000	

The company is required by 31 May 1990 to pay \$1,000 further dividend withholding payment, plus \$100 DWP penalty tax.

If the payment is not received until 30 June 1990, the company will be liable for

\$ 1,000 further dividend withholding payment

\$ 100 penalty by way of additional tax

\$ 100 DWP penalty tax

\$ 10 penalty by way of additional tax

### **Section 394ZZH - Remissions and refunds of DWP penalty tax**

The Commissioner has power to remit DWP penalty tax in certain circumstances:

1. where liability for the penalty tax has arisen because the Commissioner has determined that there has been a tax avoidance arrangement, and it is subsequently established that there was no such arrangement;
2. where the DWP penalty tax arose because the Commissioner had posted to the company a refund of DWP which it had not received at 31 March. The debit to the DWPA for a refund of DWP arises on the date it is paid by the Commissioner - so a debit may arise on, say, 31 March and the company may not be aware of this until some days later.

Late payment penalties for the DWP penalty tax are also remitted.

There still arises a liability for further dividend withholding payment in the second instance.

In the first case, late payment penalties for the further dividend withholding payment for which the company would have been liable are also remitted. There will be no further DWP payable if the original debit entry is reversed by a credit entry under section 394ZV(1)(d) (see page 24).

#### **Section 394ZZI- Application of other parts**

This provision extends other Parts of the Act, so far as applicable, to dividend withholding payment penalty tax.

#### **Section 394ZZJ - Debits and Credits Incorrectly Recorded**

The Commissioner has power where a credit or debit has been incorrectly recorded or omitted from the DWPA to determine the amount of the credit or debit arising to the account.

The relevant debit or credit is deemed to be the amount determined by the Commissioner and to have arisen on the date determined by him.

The Commissioner is required to give notice of the determination to the company. The company may object to the determination.

#### **Section 394ZZK - Dividend paid before 1 February 1989**

A DWP company which paid a dividend between 1 April 1988 and 31 January 1989 may retrospectively attach a DWP credit to that dividend. It must make the determination to do so by 31 March 1989. Where a company so determines, it must:

- (a) Debit the DWPA, as at the date of payment of the dividend, with the amount of the credit attached;
- (b) Complete the company dividend statement, and give to the shareholder a shareholder dividend statement, at the time it makes the determination.

The allocation rules apply to the year ended 31 March 1989 as they do to any other year. Therefore all dividends paid during the year must have DWP credits attached at the same DWP ratio.

Subsection (4) requires any ratio change declaration in respect of dividends paid during the transitional period (1 April 1988 to 31 January 1989) to be filed by 31 March 1989.

#### **Section 394ZZL - Dividend received before 16 December 1988**

Where a company received a foreign dividend on or after 1 April 1988 but before 16 December 1988 it was not liable to deduct dividend withholding payment from the dividend in accordance with the normal rules for deduction of DWP.

However, dividend withholding payment in respect of all foreign dividends received during the quarters ended June, September and December 1988 were to be made to the Commissioner not earlier than 16 December 1988 and not later than 14 February 1989 as if such deductions had been made.

## PART C - BRANCH EQUIVALENT TAX ACCOUNTS

In brief, under the international tax regime, New Zealand resident individuals, companies and other entities with an income interest in a controlled foreign company (CFC) are liable to pay tax on a branch equivalent basis - i.e. they pay tax on the income of the CFC as if it were a branch. If the income of the CFC is subsequently distributed as a dividend to the New Zealand taxpayer there will be double taxation on that income.

For a company, this arises because companies are liable for dividend withholding payment on foreign source dividends.

For individuals and trusts there is double taxation - firstly under the branch equivalent regime and then when the dividend is returned as assessable income.

The operation of a branch equivalent tax account (BETA) is intended to prevent such double taxation. Part XIIC of the Act provides for the maintenance of a BETA.

### **Section 394ZZM - Interpretation**

The terms defined for the purposes of the imputation and dividend withholding payment regimes have the same meanings for the purposes of Part XIIC.

The following sections deal separately with BETA persons and BETA companies. BETA persons are persons other than companies who maintain a BETA. However, life insurance companies are treated as BETA persons.

### **BETA Companies**

#### **Section 394ZZN - Election to maintain BETA**

A company may during an imputation year (1 April to 31 March) elect to maintain a BETA for that year and subsequent years. Where it does so, it is to notify the Commissioner within 21 days after the date of election or such further time as the Commissioner may allow.

The company may in a subsequent imputation year elect to cease to be a BETA company from the beginning of the following year. This election is of no effect, however, unless the company files the annual imputation return required for the year in which the election is made. This contains information on the BETA account - see section 394J. Unlike the ICA and WPA, the BETA may not run into debit.

#### **Section 394ZZO - BETA of a company**

BETA companies are required to record in the BETA the opening balance of the account and debits and credits as they arise under section 394ZZP.

The opening balance for the imputation year beginning on 1 April 1988 is nil. Thereafter, it is the closing balance for the previous year.

#### **Section 394ZZP - Debits and Credits to BETA**

##### **Credits**

The only type of credit which arises to the BETA is in effect the amount of income tax payable by the company on its CFC income under the branch equivalent regime for an income year. This is calculated in accordance with the formula in subsection (1):

$$(a + b) \times \frac{c}{d} - b$$

where:

a = the amount of income tax payable by the company for any income year beginning on or after 1 April 1988

b = the amount of foreign tax credit allowed under section 245K or 245L in calculating the income tax payable by the company for that income year

c = the lesser of:

- (i) the amount of attributed foreign income (see section 245G) derived by the company during that income year
- (ii) the taxable income of the company for that year - this includes the amount in item (i) above

d = the taxable income of the company for that year (i.e. the amount in c (ii))

**The credit arises on the date the company files its income tax return for that year.**

### **Debits**

The following debits arise to the BETA of a company:

#### 1. Offset of withholding payment liability

Where a BETA company receives a dividend from a CFC in which it has an income interest, it may use a credit in its BETA to offset the liability for withholding payment on the dividend (refer to section 394ZZQ and also to the explanation below of this commentary). The amount by which the liability is reduced is a debit to the BETA.

The debit arises on the date by which the company is required to pay the DWP that is reduced by the BETA credit - i.e. on the 14th of January, April, July or October.

#### 2. Credit to ICA

A BETA company may elect to transfer credits from its BETA to its ICA - refer to section 394ZZQ and the explanation below. Where it does so, the amount transferred to the ICA is a debit to BETA which arises on the date the company elects to credit the ICA.

#### 3. Refund of income tax

Any refund of income tax paid in relation to attributed foreign income derived in respect of an income interest in a CFC. This arises on the date the refund is paid.

#### 4. Loss of continuity of shareholding

A debit arises to BETA where there is a loss of continuity of shareholding to the extent referred to in subsection (3)(d). This provision (and subsections (5) and (6)) is identical to those which apply in respect of the ICA and WPA - refer to the discussion of those provisions on pages 4 and 24 of this commentary.

#### 5. Ceasing to be resident in New Zealand

Where a company ceases to be resident in New Zealand, a debit arises to the account of the amount equal to the credit balance at the date the company ceases to be resident.

### **Section 394ZZO - Transfer to ICA or Reduction of Dividend Withholding Payment**

Section 394ZZQ permits a company to apply a credit balance in BETA in either of two ways:

- a BETA company may elect to transfer credits from its BETA to its ICA. The company does so simply by debiting the BETA and crediting the ICA.
- As noted on pages 32 and 33, a BETA company may use credits in its BETA to offset a liability for withholding payment on receipt of a dividend from a CFC in which it has an income interest.

### **Example**

A company has in its BETA a credit balance of \$200 (this means it has paid income tax of \$200 under the CFC regime). It receives a dividend of \$1,000 (including \$150 withholding tax deducted) from a CFC in which it has an income interest.

The liability for dividend withholding payment is, at the current company tax rate of 33%.

$$(\$1,000 \times .33) - 150 = 180$$

The company may elect to use \$180 of the credit balance in its BETA to offset that liability. The BETA would be debited with \$180 and the ICA would be credited with \$180.

### **Section 394ZZR - Incorrect entries in BETA of Company**

The Commissioner has power to correct entries to the BETA of a company in the same way as he has for the ICA and WPA. Where a debit or credit has been incorrectly recorded or omitted, the Commissioner is to determine the amount of the credit and the time at which it arises.

Note that BETA companies are required by section 394J(1)(e) to include in their annual imputation return details of entries in the BETA account.

## Branch Equivalent Tax Accounts of Persons

### **Section 394ZZS - Person electing to maintain a BETA**

Any person, other than a company but including a life insurance company, may elect during an income year to maintain a BETA for that year and following years. The person is to notify the Commissioner that the election has been made within 21 days of the election or such further time as the Commissioner may allow.

The person may elect to cease to operate a BETA as from the commencement of the year following the year in which the election to cease is made. This is of no effect unless the annual BETA return has been filed for the year in which the election is made.

The BETA of a person is operated on an income year basis. The account may not run into debit.

### **Section 394ZZT - BETA of a Person**

A BETA person is to record in the BETA the opening balance of the account and debits and credits as they arise under section 394ZZU.

The opening balance for the BETA is nil in the first year of operation and is the closing balance of the previous year in subsequent years.

### **Section 394ZZU - Debits and Credits Arising**

#### **Credits**

The only credit which arises to the BETA of a person is, in effect, income tax payable under the CFC regime.

That is calculated using the formula in subsection (1):

$$(a + b + c) \times \frac{d}{e} - c$$

where a = the amount of income tax payable for the income year by the person

b = rebates deducted under section 57

c = foreign tax credits allowed under section 245K or 245L

d = the lesser of . . . :

- (i) the amount of attributed foreign income (see section 245G) derived by the person during the year
- (ii) the taxable income of the person for the year

e = the taxable income of the person for the year (d(ii))

The credit arises on the date on which the person files an income tax return for the income year in which the attributed foreign income was derived.

#### **Debits**

The following debits arise to the BETA of a person:

##### 1. Credit against tax payable

Where a person receives a dividend from a CFC in which the person holds an income interest, credits in the BETA may be used to offset the tax on that dividend - see section 394ZZV and the explanation below. The amount which is credited against income tax payable is a debit to the BETA which arises on the date the person elects to offset credits against tax payable.

##### 2. Refund of income tax

Where there is a refund of income tax which is attributable to tax paid in relation to attributed foreign income, that amount is a debit to BETA which arises on the date the refund is paid.

3. Loss of continuity of shareholding

The loss of continuity provisions (in this case relating to life insurance companies) which apply to the BETA are identical to those which apply to the ICA and WPA - refer to the commentary on section 394E(3) at page 4.

**Section 394ZZV - Offsetting of income tax payable on dividend**

Where a person who operates a BETA receives a dividend from a CFC in which it has an income interest, the person may use credits in the BETA to offset payment of income tax on the dividend.

That person records the amount which is credited against tax payable on the dividend as a debit in BETA.

The BETA credits are credited against tax payable on the dividend only if the person has paid the income tax which gave rise to the credits in BETA. (Note: the credits to BETA arise when the person files a return).

**Section 394ZZW - Annual BETA returns**

A person who operates a BETA is required to file an annual BETA return in the prescribed form for each income year that the person is required to maintain the account.

The return should set out the opening and closing balances of the account and the amount and source of all credits and debits arising during the year.

This return is to be filed by the date allowed for filing the income tax return for the year - it is anticipated that the return will be filed with the income tax return for the year.

The Commissioner has power to require a person to file a return for any period (subsection (4)).

Where a BETA person ceases to be resident that person is required to file a BETA return for the period from the beginning of the year to the date the person became non-resident.

**Section 394ZZX - Limit on refund of income tax**

This provision applies both to companies and other persons who operate a BETA. Unlike the ICA and WPA, the BETA may not operate in debit. The only entry which may conceivably place the BETA in debit is a refund of tax paid which relates to attributed foreign income.

Therefore, where the company or person is entitled to a refund of income tax paid in respect of attributed foreign income, the amount of refund is reduced so that the BETA will not go into debit. Where it is reduced, the amount not refunded to the company or person will be retained by the Commissioner and will not be available for credit in payment of tax.

This is because in the case of a company the amount not refunded represents an underpayment of dividend withholding payment. For a person other than a company the amount not refunded is an amount which has already been claimed as a tax credit.

**Example - Company**

		\$
25 June 1989	Foreign source Dividend received from CFC (includes foreign w/t) 1,000	
	WP liability	330
	Less foreign w/t	<u>150</u>
	WP liability	180
14 July 1989	Less BETA credit	<u>100</u>
	WP liability	80

Assuming the company has paid \$100 of tax on Branch-equivalent income for the year to 31 March 1989 and files its tax return on 1 June 1989, the BETA entries will be as follows:

		BETA	
		Dr	Cr
1 June 1989	Tax payable per return		100
14 July 1989	WP offset	100	

on 15 December 1989 the company is entitled to a refund of tax of \$20 - it overpaid tax in relation to attributed foreign income. This refund would place the account in debit.

If the company had not overpaid tax the amount standing to the credit of BETA at 1 June 1989 would have been \$80. Therefore the company would have been required to make a withholding payment of \$100 not \$80. Because the amount of a refund will always represent withholding payment underpaid, the amount of the refund will be retained by the Commissioner.

Example - Person other than a company

		Dr	BETA \$	Cr
30 June 1989	Tax on attributed foreign income (1989 return filed)			1,000
1 August 1989	Dividend received from CFC - \$5,000			
30 June 1990	Offset of tax payable on dividend	1,000		
15 July 1990	Refund of 1989 tax on attributed foreign income - \$200			

No refund will be made as it would put the BETA into debit. The amount not refunded represents a tax credit which the person has in effect obtained to which he would not have been entitled if the correct amount of tax had been paid. The correct amount of tax on attributed foreign income for the 1989 year was \$800. The offset of tax payable on the dividend at 30 June 1990 should therefore have been only \$800. By retaining the refund, the Commissioner allows only the correct amount of tax.



## PART D - IMPUTATION RELATED AMENDMENTS

The commentary below covers the amendments in Part IV of the Income Tax Amendment Act (No. 5) 1988 that are related to or consequent on the new imputation regime. Therefore, sections 30, 31, 33 - 44, 43, 49, 51 and 52, which make amendments related to bonus issues, dividends, producer boards and co-operatives, fringe benefit tax, and excess retention tax, are covered in separate commentaries on those subjects as appropriate.

### Section 32 - Assessments, determinations of loss etc.

Section 32 amends section 19 of the principal Act by inserting subsection (1A) to provide that any adjustment made by the Commissioner to the amount of imputation credits or dividend withholding payment credits or certain BETA credits claimed by a taxpayer is deemed to be part of an annual assessment. In such event the standard assessment and objection procedures of the Act will apply.

Section 19 is also amended to provide that determinations by the Commissioner in respect of entries to the ICA, DWPA, and BETA are to be treated in the same way as determinations of loss for the purposes of the objection procedures of the ACT.

### Section 45 - United Kingdom tax on dividends

This section makes a consequential amendment to section 308 of the principal Act to amend the reference in that section from section 4(6) of the Act to section 394ZC(3). The amendment is consequent on the repeal of section 4(6) and the insertion of the provisions of that subsection into section 394ZC(3).

Section 394ZC(3) provides that where a taxpayer is entitled, either under United Kingdom law or under the New Zealand/United Kingdom double tax treaty, to a tax credit in the United Kingdom in respect of a dividend received from a United Kingdom company, the amount of the dividend is deemed to be increased by the amount of the tax credit.

Section 308 provides that, for the purpose of allowing credit for foreign tax under Part VIII of the Act and the double tax treaty, the United Kingdom tax payable on such a dividend is deemed to be the full amount of tax on the dividend, even if that tax may not actually be paid (e.g. an imputation credit).

### Section 46 - Interpretation provision relating to non-resident withholding tax (NRWT)

Section 46 repeals the previous section 309 of the principal Act and substitutes a new section 309. The amendment includes within the definition of the term "dividends" for the purposes of Part IX of the Act any dividend withholding payment (DWP) credits attached to dividends. Any imputation credits attached to dividends are excluded.

The reason for this is that non-resident shareholders are entitled to the benefit of DWP credits but not to imputation credits.

Where dividends are paid to a non-resident shareholder the calculation of NRWT is based on the amount of the dividends paid plus the amount of any dividend withholding payment credits attached to the dividends,

for example -

dividends paid	\$720	
imputation credits attached	\$200	
DWP credits attached	<u>\$ 80</u>	\$1,000
non-resident withholding income (dividends + DWP credits)	\$800	
non-resident withholding tax (30%) (or 1596 under a double tax treaty)	\$240	

For the purposes of Part IX, the term "dividends" also does not include any dividends in respect of which winding up distribution tax has been paid. Therefore where winding up distribution tax has been paid in respect of dividends paid to a non-resident shareholder such dividends are not included in non-resident withholding income and no NRWT is payable on those dividends.

### Section 47 - Non-resident withholding tax imposed

This section repeals section 311 of the principal Act and substitutes a new section. The only difference in substance is to provide that persons liable to pay NRWT will be deemed to have paid the tax to the extent that the amount of any dividend withholding payment (DWP) credit is included in non-resident withholding income. The effect is that DWP credits attached to the dividends may be credited against the NRWT liability and will therefore reduce the amount of NRWT payable in respect of those dividends. To take the example above (refer to section 46), the amount of NRWT payable will be \$160 being the amount calculated (\$240) reduced by the DWP credits (\$80).

Should the DWP credits attached to dividends exceed the amount of the NRWT calculated there will be no NRWT payable and the non-resident will be entitled to apply for a refund of the excess.

#### **Section 50 - Payment of NRWT to Commissioner**

Section 50 amends section 319 of the principal Act by inserting a new paragraph (c) to cover the situation where NRWT is not deducted or is not deducted in full because dividend withholding credits in excess of the proper amount are attached to a dividend. In such a case the shareholder receiving the dividend is required to pay the amount of NRWT that has not been deducted.

#### **Section 53 - Amendment of tem “residual income tax”**

This section amends the definition of “residual income tax” in section 375 of the principal Act to allow provisional taxpayers to take into account -

imputation credits and dividend withholding payment credits deducted from or set off against income tax payable by a taxpayer, and

certain BETA credits offset against income tax payable on dividends received in respect of income interests in controlled foreign corporations

in calculating the amount of provisional tax payable in respect of the 1990 and subsequent income years.

In summary, provisional tax is, at the option of the taxpayer, calculated with reference to the previous year's income tax payable less certain listed tax credits. This list now includes the above credits (see previous paragraph). The effect of the amendment is that for the 1990 and subsequent income years provisional tax instalments will be payable on a basis that takes into account imputation, dividend withholding payment, and certain BETA credits claimed in the previous year.

#### **Section 54 - Offset of further income tax**

Section 54 inserts a new section 378A into the principal Act to provide that any payment of an amount of further income tax under the imputation regime (refer to section 394L) is to be set off against subsequent instalments of provisional tax instalments.

Where a company pays further income tax in accordance with section 394L, the amount of the payment is credited in payment of the next provisional tax instalment that is payable after the date of payment of the further income tax. To the extent that there remains an amount of further income tax uncredited, that amount is to be credited in payment of subsequent provisional tax instalments in the order that they fall due and payable.

#### **Section 56 - Refund of excess tax**

Section 409 has been amended to make that section subject to the restrictions on refunding income tax which are contained in sections 394M, 394ZO and 394ZZX. This will enable the Commissioner to retain any refund of income tax or dividend withholding payment to the extent to which that refund exceeds the credit in the company's ICA, DWPA, or BETA, as appropriate, at the end of the preceding imputation year.

#### **Section 57 - Tax paid in excess offset against additional tax**

Section 410, which empowers the Commissioner to offset an excess of tax payable against unpaid tax for another year, has also been amended to make that section subject to sections 394M, 394ZO and 394ZZX which impose limitations on refunding of income tax.

#### **Section 58 - Interest on tax overpaid**

This section amends section 413A of the principal Act by adding imputation credits, dividend withholding payment credits, and certain credits to the BETA to the definition of the term “residual income tax”. This allows such credits to be deducted from tax payable when calculating the amount of residual income tax for the purpose of determining the interest to be paid by the Commissioner on the difference between provisional tax paid for an income year and residual income for that year

The amendment also inserts subsection (3A) into section 413A so that the Commissioner is not required to pay interest in respect of the amount of a refund of income tax retained in accordance with section 394M and 394ZZX.

#### **Section 59 - Keeping of business records**

Section 428 of the Income Tax Act has been amended to require companies to maintain for 10 years records of ICA, DWPA and BETA accounts, company dividend statements and foreign withholding payment dividends received. BETA persons (other than companies) are also required to keep a record of the BETA account.

# APPENDIX TO TIB NO.1, JULY 1989

## EXPLANATION OF INCOME TAX AMENDMENT (NO. 5) ACT 1988 - PART IV

### CONTENTS

	Page
1. PART A - IMPUTATION	
Imputation credit account	
- Requirement to maintain	1
- Credits	1
- Debits	3
- Loss of continuity of shareholding	4
- Attaching credit to dividend	6
- Allocation rules	6
- Ratio change declaration	7
- Credits and debits incorrectly recorded	14
- Transitional	15
Company dividend statement	7
Shareholder dividend statement	7
Annual imputation return	7
Further income tax	8
Limitation on refunds	8
Imputation penalty tax	9
Shareholders and imputation	
- Imputation credits	9
- Trusts	10
- Partnerships	10
- Maximum credit allowable	7
- Shareholder dividend statement	7
- Disallowance of credits	6
- Credit of tax	12
- Carry forward	12
Anti-avoidance provisions	
- Stapled stock	12
- Tax advantage arrangements	12
Statutory producer boards and co-operative companies	
- Producer boards	15
- notional dividends	16
- cash distributions	17
- co-operative companies	18
2. PART B - DIVIDEND WITHHOLDING PAYMENT REGIME	19
Dividend withholding payments	
- Deduction provisions	19
- Payment requirements	20
- Companies in loss	20
- Refunds	21
- Offences	24
Shareholders and dividend withholding payment credits	
- Credit of tax	22
- Refunds to non-residents and tax exempts	22
Dividend withholding payment accounts	23

- Election to maintain	23
- Credits	23
- Debits	24
- Attaching credits to dividends	24
- Allocadon rules	24
- Combined ratio	25
- Transfer of credit balance to ICA	25
- Credits and debits incorrectly recorded	27
- Transitional	27
Company dividend statement	25
Shareholder dividend statement	25
Annual dividend withholding payment account return	25
Further dividend withholding payment payable	26
Dividend withholding payment penalty tax	
- Liability to pay	26
- Remissions and refunds	26
3. PART C - BRANCH EOUIVALENT TAX ACCOUNTS	
Companies	28
- Election to rnaintain BETA	28
- Credits .	28
- Debits	29
- Transfer of credit balance	29
- Incorrect entries	29
Persons	30
- Election to maintain BETA	30
- Credits	30
- Debits	30
- Offset of income tax payable	31
Annual BETA returns	31
Limitation of refund	31
4. PART D - IMPUTATION RELATED AMENDMENTS	33
Assessment and objection procedures	33
Non-resident withholding tax	33
Offset of further income tax	34
Keeping of business records	34