Company law tax changes

Introduction

The tax changes made in Part 1 of the Income Tax Amendment Act have been enacted to accommodate changes made in 1993 to company law. The Companies Act 1993 and changes to the Companies Act 1955 take effect from 1 July 1994. The resulting tax amendments therefore also generally apply from that date.

Company law changes

From a tax perspective, the most significant aspects of company law reform are as follows:

- Companies registered under the Companies Act 1993 are able to repurchase their shares either directly from all or selected shareholders, or through the stock exchange.
- There are new, administratively simpler rules applying to the amalgamation of companies which should result in an increasing number of amalgamations.
- Many of the concepts applicable to companies registered under the Companies Act 1955 - such as paid up capital, share premium and private and public company - have been abandoned and do not apply to companies registered under the new Act.
- In certain circumstances, distributions made by insolvent companies may be recovered from shareholders.

Summary of consequential tax changes

The tax changes that have been made to accommodate the reforms referred to above are summarised below and discussed in detail in the following pages. Part 1A relates to share repurchases and dividends, Part 1B provides a commentary on the amalgamation provisions and Part 1C outlines the changes in terminology throughout the Act.

In this commentary, section references are to the Income Tax Act, defined terms are in bold type when first used in commentary on an amendment, and reference to the repurchase of shares includes cancellation and redemption of shares unless otherwise stated.

Share repurchases

- New rules apply from 1 July 1994 to the cancellation, redemption and repurchase of shares undertaken by a company (whether the company is registered under the 1955 or 1993 Companies Act).
- An ordering rule applies to determine the source of distributions made on a share repurchase. The ordering rule differentiates between repurchases made by a company on the stock exchange ("on-market" repurchases) and off-market transactions.

On-market repurchases

- All on-market repurchases are funded first from subscribed capital of a company. If the company has insufficient subscribed capital, the company pays tax on the dividend component of the distribution by debiting its imputation credit account.

Off-market repurchases

- Broadly, when there is a pro-rata repurchase offer to shareholders resulting in a distribution that exceeds certain thresholds, the distribution is sourced first from the subscribed capital of a company. When the distribution falls below those thresholds, the distribution is a dividend.
- In relation to a repurchase from a selected shareholder, the distribution is funded from subscribed capital if the change in that shareholder's interest in the company resulting from the repurchase and relative to other shareholders exceeds a specified threshold.
- When a distribution exceeds the thresholds referred to in the above two paragraphs, the Commissioner has an overriding discretion to determine that the distribution is in lieu of a dividend, in which case the distribution will be treated as a dividend.
- If the distribution is a dividend, the shareholder is liable for tax on the dividend.

Revenue account shareholders

- Special rules apply to shareholders who sell shares held on revenue account to the issuing company. Except in limited circumstances, they are effectively taxed as if the shares had been sold to a third party.

Treasury stock

- The Companies Act 1993 and the Income Tax Act make provision for treasury stock (that is, shares that are not cancelled upon repurchase).

The share repurchase rules are summarised in flow chart form on pages 16 and 17 of this TIB.

Amalgamations

The Tax Act (in section 191WD) now provides for the tax consequences of an amalgamation. In particular, it provides for the following:

- the transfer of certain property on a concessional tax basis on a qualifying amalgamation
- the transfer of imputation credits and losses on a qualifying amalgamation, provided the continuity and commonality rules in the Act are satisfied.

Terminology changes

These changes have been made throughout the Revenue Acts:

- Provisions that have expired and that contain company law terms which are redundant have been repealed.
- References to the Companies Act 1955 have been expanded to include the 1993 Act.
- The term **close company** has replaced references to "private company" as the distinction between private and public companies does not exist under the Companies Act 1993. **Close company** has also replaced the concept of "proprietary company".
- References to **liquidation** have replaced references to "winding up".
- All references to paid up capital, share premium and nominal capital have been replaced with appropriate terminology.

Part 1A - share repurchases and dividends

Definitions - section 2

The following definitions have been inserted into section 2 of the Act.

Available subscribed capital per share is the subscribed capital paid in on all shares of a class, pro rated across the number of the shares in the class. The expression is used in relation to the definition of **non-participating redeemable share** (section 4A(3)), redemption of units in a unit trust (section 4A(1)(c)(iv)(A)) and elsewhere in the Act as a replacement for paid up and nominal value of a share (sections 194(5), 195(2), 197G(5)(a) and (b), 197H(7)(a) and 245C(4)(a)).

A definition of **liquidation** now appears in section 2. The definition of **winding up** has been removed. **Liquidation** includes removal from the register of companies under the 1955 and 1993 Companies Acts, dissolution of a company, or termination of a company's existence under New Zealand or foreign law . An event occurring "upon liquidation" (for example, a distribution to which section 4A(1)(ca) applies) refers to an event occurring at any time between the start of liquidation proceedings and the dissolution of the company.

Bonus issues - section 3

The definition of **bonus issue** in section 3(1) has been amended as there is no concept of capitalisation under the 1993 Companies Act.

Taxable bonus issue

A company now makes a **taxable bonus issue** (other than a bonus issue in lieu) by resolving the amount bonus issued, and notifying the Commissioner of it (section 3(3)). The amount bonus issued is a dividend under sections 4(6)(b) and 4(1)(f).

There is no change in the mechanism for making a bonus issue in lieu or calculating the dividend arising on it (see section 4(6)(a)).

Non-taxable bonus issue

The new definition of **non-taxable bonus issue** is essentially unchanged. If a company does not make the election described above when it makes a bonus issue, the issue is a non-taxable bonus issue. Non-taxable bonus issues made by companies remaining registered under the 1955 Act will have no tax effect, but they may increase paid up capital in company law. However, as a non-taxable bonus issue has no tax effect and for reregistered companies no longer results in capitalisation of reserves in company law, it will be synonymous with a share split.

Ten year bonus issue

The term "ten year bonus issue" has been repealed as the Act now refers to such issues only once, by referring to the period in which these issues were made. (See item j(i) of **transitional capital amount**, under which amounts bonus issued during this period convert to **available subscribed capital** after 10 years *or on liquidation of the company*.)

Miscellaneous technical dividend amendments

Specified payments

The reference in section 4(1)(a) to "specified payments" has been omitted as it is superfluous. "Specified payments" were defined in sections 4(3) and 4A(2) as (in effect) share premium. Distributions of share premium in cash are covered in the general category "all sums in money". There is no policy change intended by the amendment.

Distributions on repurchase of shares

Section 4(1)(g) has been expanded to include within the dividend definition amounts distributed on the repurchase of a share. Certain repurchase distributions are then excluded from the dividend definition under section 4A(1).

Group Investment Funds

Section 4(2) has been amended to clarify that an investor's interest in a group investment fund is a share for the purposes of the Income Tax Act.

Section 4A(1)(h) repealed

Section 4A(1)(h) permitted the Commissioner to characterise as paid up capital a distribution on winding up sourced from other reserves in circumstances where paid up capital had previously been reduced by a company writing off losses. As **available subscribed capital** is now defined for tax purposes, and losses written off will not affect a company's available subscribed capital, paragraph (h) has been repealed.

Recovery of distributions by company - section 4(7A)

Under section 56 of the Companies Act 1993 a distribution made to a shareholder by an insolvent company may be recovered by the company in certain circumstances. A new section 4(7A) has been inserted, which effectively reverses the tax consequences arising from the distribution in circumstances in which the distribution is recovered. The provision operates on the assumption that the amount recovered from the shareholder will be the net dividend (that is, the dividend less any resident withholding tax deducted). The company will recover any NRWT or RWT on the dividend from the Commissioner.

When the distribution was made on repurchase of a share and sourced from **available subscribed capital**, the debit to subscribed capital arising on repurchase is in effect reversed on recovery (item c(iv) of **available subscribed capital**).

Revenue account shareholders - section 4(15)

Section 4(15) and the new section 85A provide for the tax treatment of shareholders who sell shares held on revenue account to the issuing company. Commentary on both sections appears on pages 13-15.

Exclusions from dividend definition - section 4A(1)

Section 4A(1) has been substantially amended. New paragraphs (c) to (cd) exclude from the dividend definition certain distributions to shareholders. These paragraphs replace the previous paragraph (c).

Paragraph (c) excludes a distribution made on the off-market repurchase of a share in the circumstances outlined.

Paragraph (ca) excludes subscribed capital and capital gains distributed on the liquidation of a company.

Paragraph (cb) excludes the proceeds of the repurchase of shares treated by a company as treasury stock.

Paragraphs (cc) and (cd) exclude the proceeds of sale of shares repurchased by the company through the stock exchange.

On-market/off-market distinction

The rules set out below distinguish between off-market repurchases (paragraph (c)) and on-market transactions (paragraphs (cc) and (cd)). An **on-market acquisition** is defined in section 4A(2). An off-market repurchase is any other type of share buy-back.

Under the definition of **on-market acquisition** a transaction qualifies for on-market treatment when it meets both of these conditions:

- The company acquires the share on a **recognised exchange** (defined in section 8B).
- There is no arrangement between the shareholder and the company prior to repurchase of the share for the company to acquire the share. If such an arrangement exists, the repurchase is treated as an off-market transaction.

Off-market share repurchases - section 4A(1)(c)

Paragraph (c) excludes from the dividend definition amounts distributed on the cancellation, repurchase or redemption of a share when the repurchase occurs off-market and when certain criteria are satisfied. **Non-participating redeemable shares** are treated differently to other shares in that on redemption it is not necessary for paragraph (c)(i) to be satisfied.

Off-market repurchase: non-participating redeemable shares

In order to qualify for the exclusion, redemption of **non-participating redeemable shares** must meet the conditions set out in subparagraphs (ii) to (iv). In summary, (ii) and (iii) require that the repurchase occur off the share market and that it not be in lieu of a dividend. These paragraphs are discussed further on page 6.

The distribution is not a dividend only to the extent of the **available subscribed capital per share cancelled** (subparagraph (iv)). This is the amount of **available subscribed capital** that is attributable to the class of shares to which the redeemed share belongs, spread across the shares redeemed. In effect, as long as there is sufficient subscribed capital attributable to the class to cover the redemption proceeds, no dividend will arise on redemption.

Non participating redeemable shares - definition

Non-participating redeemable share is defined in section 4A(3). It is essentially a share that has certain characteristics of debt. Such a share must meet these conditions:

1. It must be issued on terms under which it is required or permitted to be repaid before the company is liquidated.
2. It must be a redeemable share, a unit in a closely held unit trust, a section 192 or 195 debenture or a share in a co-operative company.
3. It must be a **fixed rate share** or a share on which the only amount payable by the company on redemption is the **available subscribed capital per share** (that is, the average subscribed capital per share in a class of shares). A **fixed rate share** is defined in section 8B. It means a share on which any dividend payable is a fixed percentage of the issue price, or is fixed by reference to a financial index. The effect of extending the definition to include fixed rate shares is that when a fixed rate dividend is payable on redemption of a share, the instrument may nevertheless be a non-participating redeemable share.
4. It must carry only restricted voting rights. Such a share may nevertheless carry full voting rights that meet both of these conditions:
    - They are granted only to enable the shareholder to prevent a detrimental alteration to his or her position or for remedying a default of the company
    - They arise only in such circumstances.

    Shares in co-operative companies need not be so limited.

Off-market repurchase: shares other than non-participating redeemable shares

A distribution made on the off-market repurchase of other shares must satisfy the criteria in section 4A(1)(c)(i) to (iv) in order to be excluded from the dividend definition.

"Brightline" tests - paragraph (c)(i)

If a distribution on the repurchase of a share is to be sourced from subscribed capital and be excluded from the dividend definition, the distribution must first exceed certain thresholds or "brightlines" set out in subparagraphs (c)(i)(A) to (C). Different thresholds apply depending on whether the distribution occurs in a **pro rata cancellation** or as a result of a repurchase from selected shareholders.

A **pro rata cancellation** is defined in section 4A(3) as one of these:

- the repurchase of all shares of a class
- a repurchase that does not alter the **voting interest** (or **market value interest**) of a person in a class
- a repurchase arising from an offer by the company to all shareholders of a class to acquire shares, when the voting interest (or market value interest) of any shareholder would not alter if every shareholder accepted the offer.

For example, if a company offers to repurchase one share for every five held and only certain shareholders accept the offer, the repurchase of those shares occurs as part of a pro rata cancellation.

Section 60(2) of the Companies Act allows a company which is making a pro rata offer to include in the offer a power to acquire additional shares from a shareholder to the extent that another shareholder does not accept the offer. If this occurs, for tax purposes the acquisitions are part of a pro rata cancellation. The effect of this is that if some shareholders decline a repurchase offer, the company may approach other shareholders in order to reach the thresholds discussed below.

(A) - Pro rata cancellation - return of 15% or more of company's market value

When a share is repurchased in a **pro rata cancellation** and the company distributes 15% or more of its market value on the repurchase, the distribution is not a dividend (to the extent it also satisfies the criteria in subparagraphs (c)(ii) to (iv)). The threshold is determined on the basis of the amount *actually distributed*, not the amount that would have been distributed had all shareholders accepted an offer.

The 15% threshold is described in subparagraph (A) as a **fifteen percent capital reduction**. This is defined in section 4A(3). That definition makes it clear that, in calculating the 15% of the market value of all shares in a company, **non-participating redeemable shares** are excluded. Simultaneous pro rata cancellations for separate classes of shares (except non-participating redeemable shares) may be aggregated in calculating the 15% of market value.

Market value is determined at the time the company first notifies shareholders of the repurchase. If there is no advance notification, market value is determined at the time of the repurchase.

Example

A Co has $100,000 subscribed capital and $200,000 other reserves. It has 100,000 shares owned in equal proportions by 20 shareholders. A Co has surplus funds and offers to repurchase one in every 5 shares for their market value at the time of offer ($3). All shareholders accept the offer and $60,000 is returned to shareholders (20% of the market value of the company). The distribution is funded from available subscribed capital so it is not a dividend.

(B) - Pro rata cancellation - return of 10-15% of company's market value

When a share is repurchased as part of a **pro rata cancellation** and 10% or more, but less than 15%, of the market value of a company is distributed, the distribution is not a dividend (to the extent that subparagraphs (c)(ii) to (iv) are also satisfied) *provided that both of these conditions are met*:

- The company has informed the Commissioner of the repurchase.
- The Commissioner has notified the company that the Commissioner has no reasonable grounds to conclude that the repurchase is in lieu of a dividend.

The threshold applying in subparagraph (B) is referred to as a **ten percent capital reduction**. This is defined in section 4A(3). Except in relation to the level of the distribution, the definition is identical in scope to the **fifteen percent capital reduction** described above.

(C) - Non pro rata cancellation - 15% interest reduction

If a company repurchases shares from selected shareholders (that is, the repurchase is not a **pro rata cancellation**), the repurchase proceeds are not a dividend if each such shareholder's interest in the company before the repurchase and relative to other shareholders has decreased by 15% or more following the repurchase. The exclusion applies only to the extent that subparagraphs (ii) to (iv) are also satisfied.

This reduction in a shareholder's relative interest in a company is referred to as a **fifteen percent interest reduction**. The term is defined in section 4A(3).

Interest in a company is determined by the **direct voting interests** a person holds in the company. If a **market value circumstance** exists, a shareholder's **direct market value interests** determine that shareholder's interest in the company. These terms are defined in section 8B and are used to determine interest in a company for several purposes in the Income Tax Act.

The interests of certain associates of a shareholder - such as a spouse or minor child - are aggregated when calculating the relative reduction in that shareholder's interest.

Example

A Co has 4 non-associated shareholders who each hold 20 shares in the company. Shareholder B wishes to reduce her interest in the company and the company repurchases 50% of her shares.

B's interest in the company before the repurchase relative to other shareholders was 20/80, or 25%. Following the repurchase B has 10/70, or 14.28%.

For there to be a **fifteen percent interest reduction**, B must hold after the repurchase no more than 85% of her pre-repurchase interest - that is, she must hold no more than 21.25% (85% x 25%) of the company. As she holds only 14.28% of the company, the repurchase exceeds the required thresholds so it is not a dividend (if the company also satisfies subparagraphs (ii) to (iv) (described below).

Off-market repurchase - paragraph (c)(ii)

For a distribution to be excluded from the dividend definition under **paragraph (c)**, the repurchase must not be an **on-market acquisition**. (This definition is discussed on page 4.) On-market repurchases are excluded under paragraphs (cc) and (cd).

Repurchase distribution not in lieu of dividend - paragraph (c)(iii)

For repurchase proceeds in relation to all types of share to be excluded from the dividend definition, the Commissioner must be satisfied that the repurchase was not made in lieu of paying dividends. This captures a repurchase made in lieu of paying dividends on the shares repurchased or any other shares.

The Commissioner will have regard to the factors listed in subparagraph (iii) when determining whether the repurchase is in lieu of a dividend.

Subparagraph (iii) does not apply when there is a pro rata cancellation in which 10% - 15% of the company is distributed and the Commissioner has notified the company that there are no reasonable grounds on which to conclude that the cancellation is in lieu of paying dividends.

Sufficient subscribed capital to fund distribution - paragraph (c)(iv)

Paragraph (c)(iv) is the basis of the ordering rule under which repurchase distributions that satisfy the criteria in paragraphs (c)(i) to (iii) are sourced first from subscribed capital.

A distribution is not a dividend if there is sufficient subscribed capital attributable to the class of share that includes the repurchased share to fund the repurchase. More precisely, repurchase proceeds are excluded from the dividend definition to the extent that the other criteria in paragraph (c) are satisfied and the distribution does not exceed the **available subscribed capital per share cancelled**. This is defined in section 4A(3) and is in effect the subscribed capital of a class of shares spread across the shares of that class that are cancelled at one point in time.

Example

A Co has 50 shareholders who each own 10,000 shares (all of one class). It has $500,000 **available subscribed capital** and $1,000,000 other reserves. The company has funds surplus to its needs and wishes to return them to shareholders.

A Co offers to repurchase 20% of each shareholder's shares at their market value of $3 per share. Five shareholders wish to increase their relative share of the company and decline the offer. The amount distributed on repurchase of 90,000 shares is therefore $270,000, or 18% of the market value of the company (as determined at the time the shareholders were first notified of the offer).

A Co intends to maintain its dividend distribution per share and the Commissioner is satisfied that the repurchase is not in lieu of the payment of dividends.

The distribution is not a dividend as the conditions in section 4A(1)(c) are satisfied as follows:

- There has been a **fifteen percent capital reduction** occurring as part of a **pro rata cancellation** (subparagraph (i)(A)).
- The repurchase does not occur on-market (subparagraph (ii)).
- The Commissioner is satisfied the distribution is not in lieu of paying dividends (subparagraph (iii)).
- The amount distributed per share ($3) does not exceed the **available subscribed capital per share cancelled** ($5.55 - that, is $500,000/90,000 shares) (subparagraph (iv)).

The **available subscribed capital** reduces to $230,000 (see item c of the definition of **available subscribed capital**).

Off-market repurchase: unlisted widely held trusts

Paragraph (c) treats unlisted widely held unit trusts and group investment funds in a manner that differs in two respects from the treatment of companies.

The terms **unlisted widely-held trust** and **widely held trust** are defined in section 4A(3). The latter replicates the definition in section 63(2H). In essence, it is a unit trust or group investment fund owned by no fewer than 100 investors, or a lesser number in certain circumstances.

The brightline tests in paragraph (c)(i) do not apply to redemptions of units in unlisted widely held trusts (see section 4A(1)(c)(i)(D)).

The ordering rule under which *share* repurchase distributions that exceed certain thresholds are sourced from subscribed capital does *not* apply to redemptions of units in a unit trust and interests in a group investment fund. When units and interests are redeemed, the amount excluded from the dividend definition is the **available subscribed capital per share**. This is the amount of subscribed capital attributable to units in a class averaged across those units.

Example

A unit trust issues 500 units each to A and B on 1 December 1994 at $1 per unit - this brings A's holding to 1,000 units. The unit trust elects to treat the 500 units of A issued on that date as a separate class of units. The available subscribed capital of that class of units is therefore $500.

On 31 January, the trust redeems 100 of the units for $1.50 per unit. The **available subscribed capital per share** is $1 ($500/500 units). $1 is not a dividend; $0.50 is a dividend.

Off-market repurchase: non-residents

Repurchase by non-resident company from resident shareholder

The rules outlined above that enable repurchases to be funded from subscribed capital will apply to a repurchase by a non-resident company from a resident vendor shareholder only if the shareholder has sufficient information to calculate *available subscribed capital per share cancelled.* Where the shareholder does not have this information, the company is deemed not to have such funds and the distribution will be a dividend. (See section 4A(4), discussed on page 13.)

Repurchase by resident company from non-resident shareholder

The rules that determine when repurchase proceeds are funded from subscribed capital apply to distributions to non-resident shareholders in the same way that they do to residents. However, where the distribution is not sourced from subscribed capital and gives rise to a dividend, non-resident withholding tax should be deducted on the dividend.

Distributions on liquidation - section 4A(1)(ca)

Section 4A(1)(ca) excludes from the dividend definition certain distributions made by a company upon its liquidation. Under the definition of **liquidation** in section 2, this covers a period beginning with any step legally necessary to achieve liquidation until the liquidation of the company.

Distributions from two sources are tax free on liquidation - subscribed capital and certain capital gains.

More precisely, the **available subscribed capital per share cancelled** is tax free on liquidation. This is defined as the **available subscribed capital** of a company on liquidation spread over the shares cancelled upon liquidation.

The capital gains distributed per share are referred to in paragraph (ca) as the **excess return amount**, which is defined in section 4A(3). This definition is simplified with the removal of specific reference to "share premium" but is otherwise substantially unchanged. The formula calculates the portion of a company's reserves (other than subscribed capital) that are capital gains and classifies that portion of the amount distributed per share as a tax free distribution of the capital gain. For example, if capital gains represent 1/5 of the non-capital reserves of a company, 1/5 of the amount distributed per share (excluding capital) is a tax free distribution of that capital gain.

Treasury stock - section 4A(1)(cb) and 4A(4A)

Section 4A(1)(cb) excludes from the dividend definition amounts distributed by a company on the repurchase of shares that it elects to treat as treasury stock.

Shares acquired on-market or off-market may be classified as treasury stock. The treasury stock mechanism is discussed below, both generally and as it applies to co-operative companies.

General rule

The Companies Act 1993 provides that, in general, shares repurchased by a company are cancelled upon acquisition. However, under (new) section 67A(1) of that Act, a company may resolve not to cancel shares on repurchase. It may treat up to 5% of the shares of a class in this manner. Such shares may be onsold by the company or may ultimately be cancelled. A company holding shares as treasury stock is not entitled to exercise voting rights or receive dividends in respect of the shares.

Other restrictions on treasury stock are imposed under the Tax Act. Shares that are acquired in a **pro rata cancellation** cannot be treated as treasury stock. It is envisaged that treasury stock will be used - in particular by companies that have no **available subscribed capital** remaining - to acquire, bundle together and onsell unmarketable parcels of shares and to buy out minority shareholders who hold up to 5% of shares of a class.

When a company elects to treat a share as treasury stock and the company either subsequently cancels the share, or has not sold it to a non-associate within one year, the repurchase is treated as a distribution. To the extent that the company has sufficient **available subscribed capital** on the first anniversary (or earlier cancellation), the available subscribed capital is reduced by the repurchase proceeds (subsection (4A)(d)). To the extent the company has insufficient available subscribed capital, a debit calculated under section 394E(1)(ab) arises to the company's imputation credit account (ICA). The debit arises as at the date the company acquired the shares (subsection (4A)(e)). If this retrospective debit results in an end of year debit balance in the ICA, no imputation penalty tax (or additional tax on that) will be payable. However, there is still a liability for payment of **further income tax** under section 394L.

As noted earlier, a company must sell treasury stock to a non-associate within one year if the acquisition is not to be treated as a distribution. However, if the company sells the share on the stock exchange and it is coincidentally purchased by an associate, the transfer requirement is satisfied (subsection (4A)(c)(ii)(B)).

Profits on the sale of treasury stock are exempt from tax under section 61(66) of the Act and expenditure incurred in acquiring treasury stock is not deductible.

Example

B is a shareholder in A Co which has 20 shareholders (each holding 50 shares) and no **available subscribed capital**. B wishes to retire from the company but finds no suitable purchaser for his shares. On 1 December 1994, the company repurchases the 50 shares for $10 each, resolving to hold them as treasury stock in the expectation that a purchaser may be found within one year.

The company still holds those shares on 1 December 1995. The company has no available subscribed capital at that date. A debit of $246.26 ($500 x .33/.67) will therefore arise to A Co's ICA as at 1 December 1994.

Co-operative companies

The various co-operative companies Acts enable co-operative companies to hold treasury stock up to limits specified in those Acts. Up to 20% of shares can be held as treasury stock by certain companies. These Acts will be consolidated into one Co-operative Companies Act in the foreseeable future. Currently there is no provision for treasury stock in the proposed Bill but this will be reviewed. For the present, for tax purposes the upper limit on treasury stock is that applying to a company under the relevant co-operative companies Act.

Because, in practice, co-operative companies frequently retain such treasury stock for periods longer than one year, the restrictions on the time a company may hold treasury stock do not apply to co-operative companies.

On-market share repurchases sourced from subscribed capital - section 4A(1)(cc)

Section 4A(1)(cc) excludes from the dividend definition proceeds of sale of a share that is repurchased by a company in an **on-market acquisition** - that is, on the share market - to the extent that the company has sufficient **available subscribed capital** to fund the distribution. The available subscribed capital is debited on repurchase (item c(iii) of the definition of that term in section 4A(3)).

When shares repurchased on the sharemarket are treated as treasury stock there is no on-market acquisition unless the company breaches the 5% threshold or the one year time limit applying to treasury stock (paragraph (c) of the definition of **on-market acquisition**). The effect of this is that there is no reduction in available subscribed capital and no debit to the imputation credit account of a company when a share is acquired on-market, treated as treasury stock and sold within one year.

On-market share repurchases when there is no subscribed capital - section 4A(1)(cd)

Section 4A(1)(cd) applies to generally exclude from the term "dividend" the proceeds of sale of a share that is repurchased by a company through the stock exchange when the company has insufficient subscribed capital to fund the distribution. The vendor of the share therefore receives no dividend on its repurchase. The distribution is nevertheless a dividend for two purposes - debiting the repurchasing company's imputation credit account and the recovery of a distribution made by an insolvent company.

Debit to imputation credit account

A company that repurchases a share on-market is liable for the tax payable on any part of the distribution that is not sourced from subscribed capital of the company. The tax is satisfied by a debit to the imputation credit account of the company which is calculated under section 394E(1)(ab).

Paragraph (cd) achieves this result by providing that, for the purposes of section 394E(1)(ab) and (2)(ab), a dividend arises on repurchase to the extent that the distribution exceeds a company's **available subscribed capital per share cancelled**.

Example

Shareholder B holds 5000 shares in A Co. He sells 500 of those shares through the stock exchange on 1 December 1994. A Co buys 500 shares for $3 each on that date. A Co has **available subscribed capital** of $1,000. The following tax consequences arise:

- The sale proceeds are not a dividend to B (section 4A(1)(cc) and (cd) - the **available subscribed capital per share cancelled** is $2 ($1000/500)).
- The company's **available subscribed capital** reduces by $1,000 (being the aggregate of amounts excluded under section 4A(1)(cc) - see item c of the definition of **available subscribed capital**).

- Under section 4A(1)(cd) a dividend arises for the purposes of section 394E(1)(ab) to the extent that there is an amount distributed per share that exceeds the **available subscribed capital per share cancelled** - that is $1 per share. The debit per share is $0.49 ($1 x .33/.67) and the total debit is $245 ($0.49 x 500 shares). The debit arises on 1 December 1994.

On-market acquisition by insolvent company

Under company law, when an insolvent company makes a distribution, including through an on-market repurchase, the distribution may be recovered in certain circumstances.

Paragraph (cd) deems any distribution made to a shareholder in a repurchase on the stock exchange to be a dividend for the purposes of section 4(7A) to the extent the distribution is not funded from subscribed capital. The effect of this is that, in the very rare circumstance in which a distribution made through an on-market repurchase is recovered, section 4(7A) will apply to reverse any debit to the company's imputation credit account that arose on the repurchase of the share.

On-market acquisition - non-residents

Repurchase by non-resident corporate from resident shareholder

When a resident shareholder sells shares in a non-resident company through the stock exchange, and the company repurchases the shares, no dividend arises to the resident. This is a result of the combined effect of paragraphs (cc) and (cd).

Repurchase by resident corporate from non-resident shareholder

There is no difference in treatment between on-market repurchases made from resident and non-resident shareholders. When the repurchasing company is resident and has sufficient available subscribed capital to fund the distribution, no dividend will arise to the non-resident. When the company has insufficient available subscribed capital to fund the distribution, the company debits its imputation credit account by an amount calculated under section 394E(1)(ab).

Arrangement for associate to acquire in lieu of on-market repurchase - section 394E(1A)

A new section has been inserted into section 394E, to target arrangements between a company and an associate for the associate to purchase shares of the company on-market in lieu of the company repurchasing those shares on-market. When such an arrangement exists, the purchase is treated as an on-market repurchase by the company: the **available subscribed capital** is debited if the issuing company has sufficient (item c(iii) of that definition), and to the extent that it does not, a debit calculated under section 394E(1)(ab) arises to the company's imputation credit account.

"Shares of the same class" - definition

The Amendment Act makes changes to the definition of "*shares of the same class*". This definition is critical in determining the tax treatment of share repurchases as the tax treatment is linked to the level of **available subscribed capital** (and its variants) held by a company, which is calculated for a class of shares.

Shares of the same class must carry the same voting and distribution rights. However, under the previous definition of **shares of the same class**, a company that could identify particular shares and elected to treat those shares as a separate class could do so if the issue price per share for that separate class differed from the issue price of other shares. Each of the shares in the separate class had to have the same issue price.

Paragraph (c) of the definition has been rewritten to introduce more flexibility. In order for shares to be in different classes it is no longer necessary that they have different issue prices. Shares can be treated as in the same class, separate from another class, under paragraph (c) if all of these conditions are met:

- Each of the shares in the class have the same voting and distribution rights.
- The company can distinguish those shares from others in the company.
- The company elects to treat those shares as a separate class.
- The issue price of the shares in the class is the same *or* the shares are held by the same person.

Example 1

A Co is a listed company that has issued shares over many years at different prices. They all have the same rights. The company does not elect to treat any as a separate class under paragraph (c). The shares are therefore all of the same class. The definition of **available subscribed capital** calculates the aggregate of those issue prices and **available subscribed capital per share** calculates the average subscribed capital attributable to each share in the class.

Example 2

A Co has 3 shareholders, each of whom paid a different issue price for their 100 shares in the company. Shares 1-100 owned by A were issued for $10 each, shares 101-200 owned by B were issued for $20 each and shares 201 - 300 were issued to C for $30 each. All shares have the same rights. However, the company does not wish to average the subscribed capital across all shares but intends to return the subscribed capital paid in on issue of a share to the holder of that share. The company elects to treat the shares as three separate classes.

Example 3

A Co issues to each of shareholders B and C 100 shares at $3.00 each. The shares carry the same rights. It wishes to treat those shareholders as holding shares of different classes because it does not want B to have access to C's subscribed capital on repurchase of B's shares. It is able to distinguish the shares held by B and C and elects to treat them as separate classes. B's shares therefore constitute "shares of the same class" and C's shares shares of a different class.

Available subscribed capital

Under the new Companies Act there is no concept of paid up capital and share premium, and no differentiation between different types of reserves. The Tax Act therefore now defines **available subscribed capital**. This is essentially amounts paid to the company on the issue of shares, less amounts paid out on the repurchase of shares when those amounts are not dividends.

Available subscribed capital is calculated in relation to each class of shares in a company. It is calculated according to the formula **a + b - c**, which is discussed below.

Item a - transitional capital amount

Item a equals 0 for companies incorporated on or after 1 July 1994. For other companies it is the **transitional capital amount**. This is itself defined in section 4A(3) and is essentially the paid up capital and share premium attributable to shares of a class on issue at 1 July 1994.

In particular, that amount is calculated in terms of the formula in the definition:

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

In this formula:

j is the total capital paid up before 1 July 1994 on shares of a class ever issued. However, the following two categories of paid up capital are not to be included.

1. **Unexpired ten year bonus issues:** for ongoing companies (that is, companies that are not calculating available subscribed capital on liquidation) paid up capital does not include capital arising from a bonus issue that meets all of these conditions:
   - It was made between 31 March 1982 and 1 October 1988.
   - It was sourced from reserves other than **qualifying share premium** (defined in section 4A(2)).
   - It has been issued for less than 10 years.

   However, for companies that are liquidating, this restriction does not apply and the amount bonus issued is included in the **transitional capital amount**.

   Note that the words "relevant time" in subparagraph (i)(C) of item j refer back to the opening words of subsection 4A(3).
2. **Non-taxable bonus issues:** paid up capital arising from non-taxable bonus issues sourced from reserves other than **qualifying share premium** are also not included in item j.

k is the aggregate of **qualifying share premium** that has ever been paid to the company before 1 July 1994. Share premium that has been bonus issued is excluded in order to avoid double counting such amounts - they are included already in item j.

l is the number of shares ever issued before 1 July 1994.

m Items j, k and l broadly (that is, except for the treatment of certain bonus issued amounts) calculate the amounts that would not be a dividend on cancellation of a share before 1 July 1994. This amount is then attributed to shares *on issue* at 1 July.

Example

A Co is repurchasing shares on 1 December 1994 and is calculating its **available subscribed capital**, and therefore its **transitional capital amount**, to determine how much of the distribution will be tax free to shareholders. Before 1 July 1994 A Co. had issued 500 shares (all of the same class), with paid up capital of $1 per share and share premium of $2 per share. Of those 500, it had cancelled 100 shares before 1 July for $3 per share.

The **transitional capital amount** is

$$\frac{\$500 + \$1{,}000}{500} \times 400 = \$1{,}200$$

Item b - subscriptions from 1 July 1994

Item b is the amount paid to the company on the issue of shares of a class on or after 1 July 1994. Subparagraphs (i) to (iv) clarify the amount that is credited to subscribed capital in certain circumstances. Subparagraphs (v) to (xii) list the circumstances in which consideration paid on the issue of shares is excluded from available subscribed capital.

Inclusions

Bonus issue in lieu - (i)

The amount credited to available subscribed capital when there is a bonus issue in lieu is the amount of money offered as an alternative to the bonus issue.

Taxable bonus issue - (ii)

When a company makes a taxable bonus issue (other than a bonus issue in lieu) the amount credited to available subscribed capital is the amount of dividend arising from the taxable bonus issue. This is the amount the company elects to be bonus issued under section 3(3) of the Income Tax Act.

Debt converted to equity - (iii)

When debt is converted to equity (for example, in the case of a convertible note) the amount of the debt claim converted is credited to available subscribed capital.

Short form amalgamation of sister companies - (iv)

When two companies that are wholly owned by the same parent amalgamate in a short form amalgamation, the amount of available subscribed capital that arises in relation to each class of share in the amalgamated company is the available subscribed capital of all shares of an equivalent class in the amalgamating companies. Crossholdings are not counted.

Example

A Co and B Co were each incorporated in December 1994. A Co issued 1,000 shares for $1 each. B Co issued 2,000 shares for $1 each. All of the shares in A Co and B Co are held by C Co.

C Co

A Co B Co

A Co and B Co amalgamate using the short form amalgamation procedure in section 222(2) of the Companies Act 1993. A Co remains as the amalgamated company.

The available subscribed capital of the amalgamated company will be as follows :

a + b - c

"a" = 0

"b" = 1,000 + 2,000

"c" = 0

The available subscribed capital of the amalgamated company is therefore $3,000.

Item b(iv) is required because, under a short form amalgamation, all shares in the discontinuing amalgamating company are cancelled without payment or other consideration, including the issuing of shares in the amalgamated company. As item b only includes consideration provided for shares issued, a specific provision is required to ensure that the available subscribed capital of the amalgamated company includes an amount equal to the available subscribed capital of the amalgamating company.

Exclusions

Non-taxable bonus issue - (v)

The making of a non-taxable bonus issue does not result in an increase in available subscribed capital.

Taxable bonus issue exempt under section 63 - (vi)

No increase in a company's available subscribed capital arises if the company makes a taxable bonus issue to a parent company which is exempt from tax on the bonus issue under section 63. This restriction applies to the extent that the bonus issue is not **fully credited** - that is, it does not carry imputation credits at the maximum ratio. "Fully credited" is defined in section 4A(3).

Dividend exempt under section 63 - (vii)

There is also no increase in a company's subscribed capital if consideration the company receives on the issue of shares is primarily attributable to a dividend it pays that is exempt from income tax under section 63 and not subject to foreign dividend withholding payment.

Example

A Co pays a dividend to its parent B Co, which is exempt from tax on the dividend under section 63. B Co uses those funds to subscribe for shares in A Co. This transaction does not result in an increase in A Co's available subscribed capital.

Dividend paid by CFC to CFC - (viii)

An equivalent restriction to that in subparagraph (vii) applies when consideration received on the issue of shares by a controlled foreign company (CFC) is attributable to a dividend paid by that CFC to another CFC.

Share-for-share swaps - (ix)

Subparagraph (ix) restricts the amount of available subscribed capital arising in one company on its acquisition of shares in another company. It has its basis in the concept of **qualifying share premium**. The purpose of the rule is to prevent share swaps being used to generate available subscribed capital in excess of that available for distribution before the share swap.

The basic rule is that when the consideration provided for the issue of shares in A Co is in the form of shares in B Co the subscribed capital of A Co increases only by the available subscribed capital of those shares in B Co.

Example

A Co intends to take over B Co. B Co has revenue reserves of $900, available subscribed capital of $100 and a market value of $1,000. Therefore $900 of B Co would be taxable on distribution. A Co buys B Co by issuing shares to B Co's shareholders in return for their shares in B Co. In the absence of the restriction in subparagraph (ix), the shares issued by A Co would have subscribed capital of $1,000, being the market value of B Co. Under subparagraph (ix), the subscribed capital of the A Co shares is limited to $100, being the subscribed capital of B Co.

Anti-avoidance provision

The basic rule is strengthened by the requirement to deduct **ineligible capital amounts** from the available subscribed capital of shares offered in exchange. This is defined in section 4A(3) and is best explained by an example that shows its effect. It is intended to prevent the underlying rule being avoided by an arrangement of the following kind.

Example

A Co intends to take over B Co. B Co has revenue reserves of $900, available subscribed capital of $100 and a market value of $1,000. A Co buys B Co by offering to issue A Co shares to B Co's shareholders in return for B Co shares. Under the proposed rules the shares issued by A Co will have subscribed capital of $100, being the subscribed capital of B Co.

These rules can be undermined if, immediately before the share swap, B Co's shareholders subscribed another $900 to B Co. B Co now has subscribed capital of $1,000 and a market value of $1,900. A Co then buys B Co shares for shares worth $1,000 and $900 cash, thus returning the $900 recently subscribed. The issued shares will have subscribed capital of $1,000. The transaction enables the subscribed capital of the A Co shares to be increased by $900.

Under the **ineligible capital amount** definition the $900 subscribed immediately before the share swap is ignored when calculating the available subscribed capital of B Co, so that the subscribed capital of the newly issued shares is limited to the original $100 of subscribed capital.

The **ineligible capital amount** is therefore:

- the available subscribed capital of shares in B Co that is attributable to shares issued in anticipation of the acquisition ($900); or
- if it is less than the amount above, the amount of available subscribed capital attributable to consideration passing from A Co to B Co's shareholders that is not in the form of shares ($900).

Amounts that are fully credited taxable bonus issues are not included in the calculation of "ineligible capital amount". It is quite legitimate for such bonus issues to be made before a takeover, in order to prevent loss of imputation credits.

Share for share swaps on an amalgamation - (x)

Subparagraph (x) provides a rule equivalent to subparagraph (ix) above but which applies on amalgamation of companies. The available subscribed capital of an amalgamated company does not include the amount of any consideration it receives on amalgamation to the extent the consideration provided by shareholders of the amalgamating company exceeds the subscribed capital per share of the shares in the amalgamating company.

Example

A Co has available subscribed capital of $600 and a market value of $1,000. B Co holds all of the shares in A Co. C Co has available subscribed capital (consisting of a **transitional capital amount**) of $300.

A Co amalgamates with C Co using the long form amalgamation procedure (section 220 of the Companies Act 1993). C Co remains as the amalgamated company.

Shares in A Co are cancelled. Assets and liabilities of A Co are transferred to C Co. B Co receives shares in C Co to the value of $1,000.

The available subscribed capital of C Co is calculated as follows :

a + b - c

"a" = $300

"b" = $600 ($1,000 - $400)

"c "= 0

The available subscribed capital of the amalgamated company is therefore $900.

Double counting of transitional capital amount - (xi)

Subparagraph (xi) excludes from available subscribed capital any amounts that have already been included under item a - **transitional capital amount**.

Treasury stock - (xii)

Subparagraph (xii) clarifies that when a company disposes of a share that has been treated as treasury stock, there is no increase in its available subscribed capital.

Item c - debits to available subscribed capital

Item c provides for a decrease in available subscribed capital upon the repurchase or cancellation of a share on or after 1 July 1994, if the repurchase proceeds are excluded from the dividend definition because there is sufficient subscribed capital to fund the distribution.

When an insolvent company recovers a distribution from subscribed capital from a shareholder under section 56 of the Companies Act 1993, the debit to subscribed capital at the time of the distribution is in effect reversed (subparagraph (iv)).

When there is an arrangement of the kind referred to in new section 394E(1A) (described on page 9 above), to the extent that there is sufficient available subscribed capital in the issuing company to cover the deemed repurchase, the purchase proceeds will be deducted from the available subscribed capital of that company.

Section 4A(4)

A new section 4A(4) has been inserted, expanding the replaced subsection by adding paragraphs (b) and (c).

Paragraph (b) provides that when a shareholder of a non-resident company cannot obtain sufficient information to calculate the **excess return amount** (on liquidation of the company) or the **available subscribed capital per share cancelled** on repurchase of a share, that amount is deemed to be nil. These amounts would generally be tax free under section 4A(1)(c) to (cd).

Paragraph (c) creates an exception to the above rule. When the non-resident company is an **unlisted widely held trust** and the shareholder cannot obtain sufficient information to calculate the **available subscribed capital per share**, that amount is deemed to equal the amount paid to the trust in respect of the issue of the unit. (Note that, in relation to an unlisted widely held unit trust, the **available subscribed capital per share** and not **available subscribed capital per share *cancelled*** calculates the tax free component on redemption of a unit.)

Non-taxable bonus issue from capital gains - section 4A(11A)

New subsection (11A) provides that when a non-taxable bonus issue is sourced from a capital gain amount, the capital gain amount retains its status so that it is in most circumstances distributable tax free on liquidation. This is consistent with the treatment of non-taxable bonus issues, which are generally ignored for tax purposes.

Revenue account shareholders - sections 4(15) and 85A

Two new provisions provide for the tax treatment of shareholders who held repurchased shares on revenue account - sections 4(15) and 85A. Section 4(15) provides for the taxation of the repurchase proceeds under the dividend provisions *and* under section 65, but provides a mechanism to avoid double taxation of the proceeds.

Section 85A has two effects. First, when repurchase proceeds are a dividend because the distribution is under the thresholds in section 4A(1)(c)(i) or is in lieu of a dividend, the proceeds are treated as a dividend only - the shares are deemed not to have been sold. Secondly, the section adjusts the cost price of shares that are repurchased at under market value.

Taken together, sections 4(15) and 85A provide that if a repurchase fails to meet the conditions in section 4A(1)(c) and is therefore deemed to be in lieu of a dividend, for revenue account shareholders it will be taxed as a dividend and not as a sale. But if the repurchase is not in lieu of a dividend, any dividend component of the proceeds will be taxed as a dividend and the remainder will be taxed as a sale.

Section 4(15)

When a shareholder who holds shares on revenue account sells those shares to the issuing company, the proceeds may be taxed as a dividend. The transaction is also a sale of revenue account property and any profit or loss should be taxable or deductible. Section 4(15)(a) provides that in calculating the amount of assessable income derived on the sale of shares held on revenue account to the issuing company (for example, under section 65(2)(a) or (e)) the sale price is deemed to be reduced by the amount of any dividend arising on sale. The effective result of this calculation is that the shareholder is assessed only on the gain or loss on sale (see example 1 below).

Note that if the distribution is a dividend because it is under the thresholds in section 4A(1)(c)(i) or is deemed by the Commissioner to be in lieu of a dividend under section 4A(1)(c)(iii) (rather than because a company has no available subscribed capital), section 85A(e) would generally apply to tax the distribution only as a dividend. Section 4(15)(a) would therefore not apply.

Example 1

T holds 100 shares in A Co on revenue account. T purchased the shares for $1 each and in December 1994 the company repurchased 75 for their market value of $2.00 per share. The distribution gives rise to a **fifteen percent interest reduction** and would therefore ordinarily be sourced from subscribed capital. However, A Co has no **available subscribed capital** and the distribution is therefore a dividend.

T's income from the repurchase is:

Dividend	=	$150
Income on sale	=	Sale price (consideration less dividend) - cost price
	=	($150 - $150) - $75 = ($75)
Total income	=	$75 ($150 - $75) which equals the gain on sale

Note: If A Co had sufficient available subscribed capital to fund the distribution, T would not have received a dividend on the repurchase and the gain or loss on sale would be $75, calculated in the usual way.

The reduction in sale price does not apply when dividends are exempt under section 63 and when no foreign dividend withholding payment (FDWP) is required to be deducted.

Example 2

A Co holds shares in its wholly owned subsidiary B Co on revenue account. B Co repurchases shares, distributing $100,000 (more than 15% of the market value of B Co). The shares were acquired for $25,000. B Co has no **available subscribed capital** to fund the distribution. A dividend arises to A Co but is exempt under section 63. As B Co is resident the dividend is not subject to FDWP. In these circumstances, the dividend is not deducted from the consideration. A Co calculates the gain or loss on sale in the usual way - there is a $75,000 profit on sale.

When a foreign company is repurchasing its shares, FDWP may be payable on any dividend arising on the repurchase. When FDWP is paid, (or if a BETA credit balance is used to reduce the amount payable instead), the dividend is deducted from sale proceeds when calculating any gain or loss on sale.

To the extent that no FDWP is paid because the distribution is covered by underlying foreign tax credits, there is no deduction from sale proceeds when calculating the gain or loss on sale of shares.

Section 4(15)(b)

Paragraph (b) provides that a revenue account shareholder may be assessed on the proceeds of repurchase of a share even though the proceeds are excluded from the dividend definition.

Section 85A

Below brightline share repurchase - paragraph (e)

When share repurchase proceeds are treated as a dividend because the repurchase either falls below the thresholds in section 4A(1)(c)(i) or is in lieu of a dividend (paragraph (c)(iii)), the shareholder is deemed not to have sold the share. Rather, the distribution is treated solely as a dividend. The cost base of the share sold is not deductible but is transferred to the remaining shares of the class that the shareholder held. This treatment only applies if the shareholder continues to hold shares of the same class, which will generally be the case if a repurchase falls below the brightline.

Note that when shares are trading stock that is valued at cost, paragraph (e) will apply in the manner indicated above. However, the provision will not affect trading stock that is valued at market value.

Example

A purchases 100 shares for $1 each in B Co and holds them on revenue account. The shares are not held as trading stock. B Co makes a pro rata offer to purchase 1 in every 20 shares for their market value of $2.50. The company distributes 5% of its market value and the repurchase proceeds are therefore a dividend. A sells 5 of its shares and therefore receives a $12.50 dividend.

A is deemed not to have disposed of the shares. The $5 cost of the repurchased shares is added to the $95 cost of the remaining shares - each remaining share therefore has a cost price of $1.05 per share.

Repurchase of share at under market value - paragraph (f)

Paragraph (f) applies when there is a repurchase of shares for less than their market value and when the repurchase is treated as a sale (that is, where paragraph (e) does not apply). It provides that, in such circumstances, only part of the cost of the repurchased shares is deductible. The remainder is added to the cost base of the remaining shares and will be deductible when those shares are sold. This prevents shareholders from deriving artificial losses on sale of shares at below market value to the issuing company.

The formula that transfers part of the cost from a share disposed of to the remaining shares is set out in paragraph (f):

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

In this formula:

a is the cost of the repurchased share

b is the aggregate cost of all the shareholder's shares of the same class before repurchase

c is the consideration derived by the shareholder from the company on repurchase of the share. Note that this is always the gross consideration - not the net concept derived by applying section 4(15)

d is the market value of all the shareholder's shares in the same class before the repurchase

In effect, this formula links the allowable deduction for the cost of shares sold to the percentage of the shareholder's interest that is sold. For example, if a shareholder is disposing of 5% of the value of its interest in a class, a deduction should be permitted for 5% of the cost of shares it holds in that class. This is illustrated below.

Example 1

A Co bought 100 shares for $1 each in B Co and holds them on revenue account. They are not trading stock. At 1 December 1994, B Co buys back 25 shares at $0.50 per share. The market value of each share is $2.50. The distribution is not a dividend, but is sourced from subscribed capital as it is a "fifteen percent interest reduction".

A Co calculates the loss or gain on sale as follows:

Cost per share: $1.00

Amount excluded from cost:

$$\$1 - \frac{(\$100 \times \$0.50)}{\$250} = \$0.80$$

Adjusted cost of share disposed of $0.20

A Co is disposing of $12.50/$250 of its interest, or 5% of the market value of the interest. The aggregate allowable cost deducted is $5 ($0.20 x 25), or 5% of the total cost of all the shares.

Alternatively, this may be seen as A Co disposing of shares at 20% of their value and being able to claim only 20% of their cost.

The gain on sale is therefore $7.50 (sale price ($0.50) - cost ($0.20) = $0.30 per share x 25). The cost price of the remaining shares increases to $1.26 per share ($95/75 shares), or $95 in total.

Example 2 - Shares as trading stock

Assume that A Co now treats the shares as trading stock that is valued at cost.

Opening balance	($100.00)
Repurchase of 25 shares at $0-50 each	$ 12.50
Closing balance (cost of remaining shares ($75) plus 85A adjustment ($20) (being $0.80 x 25 shares repurchased))	$ 95.00
Net income	$ 7.50

Example 3 - repurchase proceeds are a dividend because there is no available subscribed capital

Assume that B Co in Example 2 has no **available subscribed capital** remaining and the $12.50 distributed on repurchase is therefore a dividend. Paragraph (e) does not apply. The tax consequences of the transaction are as follows:

Income: dividend	$12.50
Loss on sale	($ 5.00)
Net income	$ 7.50

The loss on sale is calculated as follows:

Gain/loss on sale per share = sale price - cost price

Sale price (under s.4(15))	= consideration - dividend = $12.50 - $12.50 = 0
Cost price	= cost - 85A adjustment
Adjustment per share	$= \$1 - \frac{(\$100 \times \$0.50)}{\$250}$ = $0.80
Cost price per share	= $0.20 ($1 - $0.80)
Loss on sale	= 0 - $0.20 = ($0.20) per share x 25 = ($5)

Resident withholding tax - section 327C

Minor changes have been made to the provisions relating to resident withholding tax on bonus issues. Resident withholding tax on all taxable bonus issues except bonus issues in lieu is to be calculated under section 327C(1)(c) according to the following formula:

$$\left(\frac{a}{1 - a} \times b\right) - c$$

In this formula:

a = the rate of resident withholding tax, currently .33

b = the amount of dividend paid

c = any foreign withholding tax, imputation or FDWP credits

For the purposes of item b of the formula, the dividend paid is the amount that the company elects under section 3(3) (see also section 4(6)). That amount is credited to **available subscribed capital** (item b(ii) of that definition).

Example

A Co resolves and elects to make an unimputed taxable bonus issue of $10,000. Resident withholding tax to be paid on the bonus issue is calculated as follows:

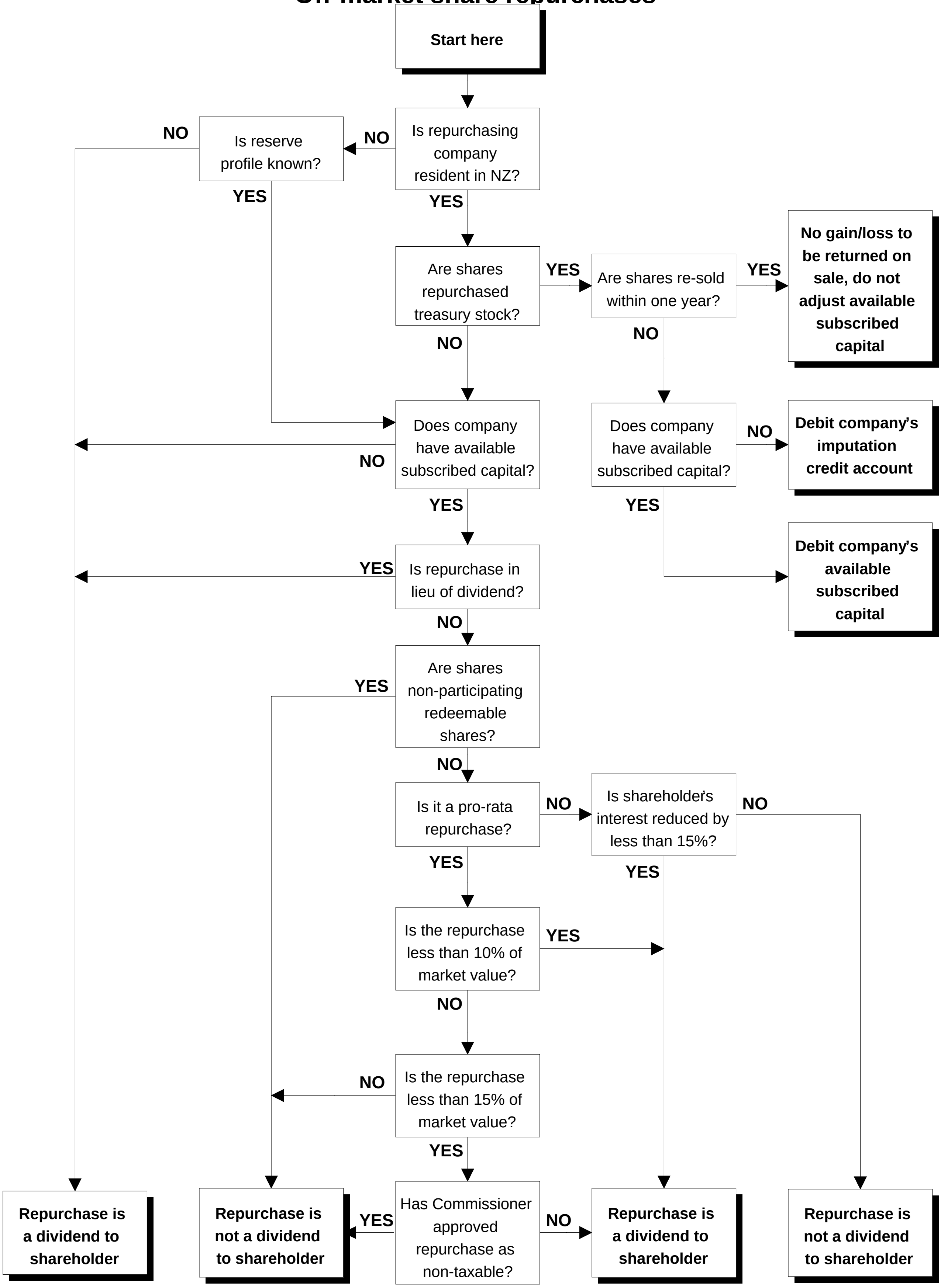
.33/.67 x $10,000 = $4,925

This results in $4,925 of tax being paid on $14,925 of gross income (being the net dividend of $10,000 and RWT of $4,925).

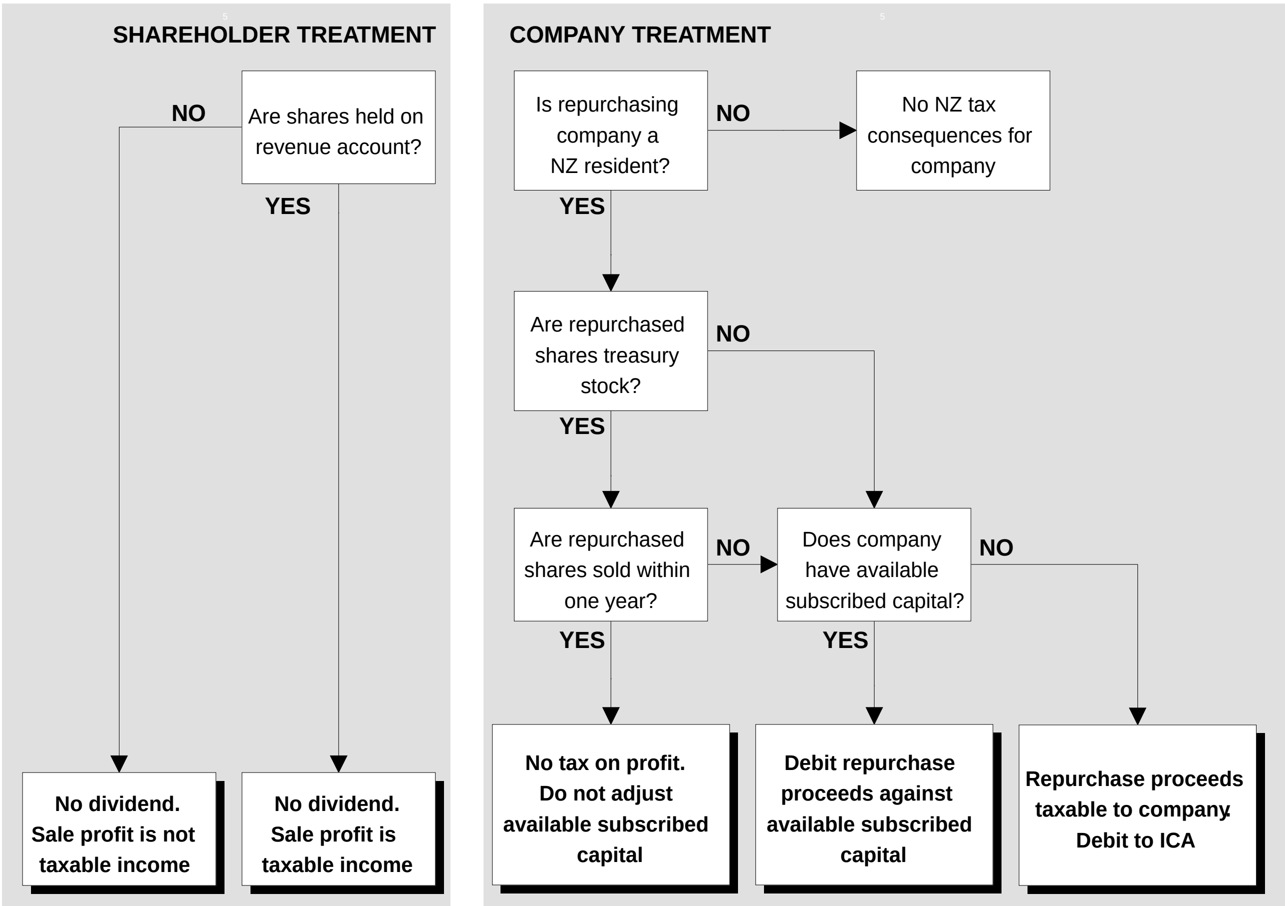
Paragraph (1)(d) has been redrafted as it now applies only to a bonus issue in lieu.

Summary flowcharts - tax treatment of share repurchases

Off-market share repurchases



On-market share repurchases



Tax treatment - revenue account shareholders