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Issue 5

Proposal to reduce tax cost to shareholders welcome

Snapshot

Officials have released a proposal to make it easier for companies to ensure their shareholders, particularly minority shareholders, are not tax disadvantaged when tax losses are offset and dividends paid.

A company that uses tax losses of another company has fewer imputation credits because it pays less tax. This means that the shareholders pay more tax as their dividends cannot be fully imputed. The Government and Officials' concern is that this makes it more attractive to acquire 100% of a company to avoid this tax issue. This presents a barrier to listings and more diverse shareholdings in New Zealand companies.

The proposal is to allow the loss company to transfer imputation credits, up to the tax value of the loss offset amount, to the profit company. This allows the profit company to add imputation credits to dividends it pays. This will allow full imputation of dividends to the extent any shortfall in imputation credits relates to use of loss offsets.

This is a welcome, albeit highly technical, solution to a practical problem.

The Government's primary concern is the current rules can drive 100% acquisition of New Zealand groups to prevent any adverse tax consequences. The wider concern is tax being a barrier to companies listing on the NZX and getting a more diverse shareholder base

The proposed solution is technically complex. Rather than simply treating dividends as exempt it aims to bridge the imputation shortfall to ensure dividends can be fully imputed

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An example to illustrate the problem and the proposed solution

Profit Co has a taxable profit of $20,000 and offsets losses of $10,000 from Loss Co. Profit Co's tax and imputation credits would be $2,800 (i.e. $10,000 x 28%).

If, say, Profit Co is 90% owned by Loss Co and 10% by an unrelated minority shareholder, it will have a total of $17,200 cash available to pay as a dividend (split 90/10) and $2,800 of imputation credits. Loss Co and the minority shareholder will have $2,520 and $280, respectively, of additional tax to pay as the dividend received will not be fully imputed.

Under the proposal, Loss Co would be able to transfer imputation credits of $2,800 to Profit Co to attach to the dividend to Loss Co and the minority shareholder. This is equal to 28% of the loss offset amount of $10,000.

This will result in the dividend to each shareholder being able to be fully imputed, removing any additional tax cost on the dividend.

The key to understanding the proposal is that the Loss Co can transfer some of the imputation credits it will receive with the dividend. It does not need to have the imputation credits to be able to transfer them to Profit Co.

This effectively notional (optional) transfer is controlled by:

- The cap being the tax effect of the loss transferred.
- The transfer only being able to be done at the time the dividend is paid and the dividend must be paid within four years of the loss offset.
- The normal imputation credit account rules (such as benchmark, streaming of credits and the required account balance) still applying.

Who will this impact and what does it mean?

The Government's primary concern is the current rules can drive 100% acquisition of New Zealand groups to prevent any adverse tax consequences. The wider concern is tax being a barrier to companies listing on the NZX and getting a more diverse shareholder base.

The exact extent of the problem for listed and potentially unlisted companies is unclear but removing the potential tax impediment is welcome.

Loss offsets are commonplace in New Zealand as they allow losses to be used in the most efficient manner, within a group. The proposal will be welcomed by those New Zealand companies where majority shareholders provide loss offsets, at the cost of a shortfall in imputation credits, which disproportionately impacts their minority shareholders.

The proposed solution is technically complex. Rather than simply treating dividends as exempt (similar to the wholly-owned company scenario) it aims to bridge the imputation shortfall instead to ensure dividends can be fully imputed (to the extent the shortfall relates to use of losses).

Submission on the Issues Paper are due by 27 October.

For further information

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