New Zealand Law Society
Te Kāhui Ture o Aotearoa

31 July 2024

Inland Revenue
By email: public.consultation@ird.govt.nz

PUB00480: Income tax – Overdrawn shareholder loan account balances

1. The New Zealand Law Society Te Kāhui Ture o Aotearoa (the **Law Society**) welcomes the opportunity to comment on draft Interpretation Statement PUB00480: Income tax — Overdrawn shareholder loan account balances (the **draft IS**). The Law Society is generally in agreement with the law as summarised in the draft statement, subject to the following comments and reservations.

2. This submission has been prepared by the Law Society's Tax Law Committee.

The Commissioner's educational function

3. As the draft IS sets out in considerable detail, the tax consequences arising as a consequence of a company advancing funds to a shareholder on other than arm's length terms can be complex, including the computation of dividends, income tax, resident withholding tax, non-resident withholding tax, imputation, fringe benefit tax, and the application of the financial arrangements rules. These tax consequences do not, we understand, frequently arise in practice, because appropriate use is made of shareholder salary allocations, and/or capital transactions, as part of the routine finalisation of accounts for closely held companies.

4. Example 9 contains a good illustration of this. When those tax issues do arise, they result in a heavy compliance burden on both the company and the shareholder, and create a potential risk in terms of the operational burden on the Commissioner. In some cases, the overdrawn account will have been inadvertent. In many cases, perhaps an overwhelming majority of cases, the compliance and administrative burden is likely to be out of proportion to any additional revenue collected.

5. The message strongly implied by the draft IS, therefore, is that companies and their shareholders should take care not to allow a company's advances to its shareholders inadvertently to produce a heavy compliance burden (and a relatively small additional liability to tax). But as the draft IS stands, that message is merely implied; it might be more helpful if it were clearly expressed. That is, it might assist taxpayers if it began with a statement alerting them to the complexity of the tax consequences likely to flow from an overdrawn shareholder loan account, and indicating the manner in which companies and shareholders are able to act within the law to ensure that these adverse consequences do not arise in practice.

Definition of 'close company'

6. Paragraph 7 of the Interpretation Statement states (footnote omitted):

Close company means a company with five or fewer natural persons or trustees who hold more than 50% of the voting interests or market value interests in the company. All natural persons associated at the time are treated as one person.

7. This is correct, but it would be helpful if the draft IS explained more clearly the chief consequence of the definition (provided for by section YA 1), which is that virtually all small companies, many medium-sized companies and many large unlisted companies are close companies.

Forgiving an interest-free loan

8. As the draft IS explains, it will generally constitute a dividend where a company either (a) lends money to a shareholder without charging interest (or charging interest at less than market) or (b) forgives a debt owed to the company by a shareholder. It might be helpful to also explain that if a company lends money to a shareholder without charging interest and then, at some later date, forgives the debt, that would generally constitute multiple dividends — the quantum being both the interest forgone (assessable quarterly) and the amount of the debt forgiven.

Directors

9. The draft IS at [42]–[57] provides appropriate and helpful detail on both shareholders and shareholder-employees. As it explains, advances made by a company to a shareholder-employee at less than market interest are generally subject to fringe benefits tax, rather than taxed as dividends subject to income tax and resident withholding tax. The draft IS does not, however, say anything about the position of directors.

10. It is common for a person who is a director to also be an employee (as well as being a shareholder), but that is not always the case. Rather, it is common for a person to be a shareholder-director, and not an employee. As the Act recognizes, a directorship is an office, not an employment.[1] For instance, a company cannot either appoint or dismiss its directors; and a director is not obliged to follow instructions issued by the company.

11. It would therefore be helpful to include an explanation of the Commissioner's position on the appropriate tax treatment of interest-free and reduced rate loans made by a company to a director. It may be that the Commissioner's position is that directors are to be treated, for the purposes of this draft IS, as if they are employees. If that is the case, it would be helpful to state so, and explain why.

Next steps

12. Should you wish to discuss any aspect of this feedback, please contact Aimee Bryant, Manager Law Reform and Advocacy (aimee.bryant@lawsociety.org.nz).

David Campbell
Vice President

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[1] Section CE 1(e), see also section 6(3)(b) Goods and Services Tax Act 1985.