EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA - MŌ TE TĀKUPU ME TE MATAPAKI ANAKE

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Send feedback to | Tukuna mai ngā whakahokinga kōrero ki public.consultation@ird.govt.nz

FACT SHEET | PUKA MEKA

Income tax – Share investments (dividends and taxable share sales)

Issued | Tukuna: Issue Date

IS ##/## FS #

This fact sheet accompanies:

- IS XX/XX **Income tax – Share investments** that considers the income tax issues that arise for individual share investors, and
- FS XX/XX **Income tax – Share investments (whether the FIF rules apply)** that explains when the Foreign Investment Fund (FIF) rules apply to individual share investors.

If you are not subject to the FIF rules, for example if you hold shares in a New Zealand company, this fact sheet explains when you have to return income from dividends or taxable share sales.

Introduction | Whakataki

1. If you hold shares in a foreign company, you first need to read FS XX/XX **Income tax – Share investments (whether the FIF rules apply)** to decide whether the FIF rules apply to you. This fact sheet does not apply if you are subject to the FIF rules. This fact sheet applies if you hold shares in a New Zealand company, or if the FIF rules do not apply to you.
2. If you are in the ordinary tax rules, you may receive the following types of taxable income:
   - dividends; and
   - amounts received from sales of shares if you bought those shares for the purpose of disposing of them, or as part of a share dealing business or profit-making scheme.
3. This fact sheet explains when you will need to return income from dividends and taxable share sales in an IR 3 individual income tax return.

Dividends

4. **You do not need to return income** when a dividend is paid by:
   - a New Zealand company; or
   - a foreign company but a New Zealand custodian holds the shares on your behalf.
5. In either of these situations, tax is withheld on your behalf by the company or custodian. You will need to check that amounts pre-populated in your individual income tax assessment or IR 3 individual income tax return are correct. If the amounts are incorrect, then you will need to include any missing amounts.
6. **You will need to return income** when a dividend is paid by a foreign company and no New Zealand custodian is involved. In this situation:
   - the amount of dividend to include is the New Zealand dollar amount, calculated at the time the dividend is paid to you;
   - if withholding tax on the dividend was paid overseas, you can claim this tax credit against your New Zealand tax liability, so you are not taxed twice on the same amount; and
   - you need to include the New Zealand dollar amount in your IR 3 individual income tax return and file an IR 1261 overseas income summary to declare your overseas income sources.

7. If you receive foreign dividends and the platform you use does not convert these amounts into New Zealand dollars, some assistance for finding out the New Zealand dollar amount is on Inland Revenue's website Overseas currency - conversion to NZ dollars.

8. You need to include income from foreign dividends in a return only if the total amount of all your income that is not reportable income for that income year is less than $200. Reportable income is typically income where tax is withheld by the payer (for example, PAYE on salary and wages, interest, and dividends paid by New Zealand companies). The $200 limit applies to all amounts that are not reportable income (for example, foreign dividends and taxable share sales).

9. For more information on how to file a return and how to report your overseas income, visit these Inland Revenue webpages:

   - Complete my individual income tax return - IR3
   - Reporting your overseas income

10. Example | Tauira 1 shows the tax consequences of dividends paid by a foreign company.

Example | Tauira 1 – Dividends from a foreign company

Bob used an online investment platform to buy shares in US Co and had provided his IRD number to the platform. The platform is non-custodial but uses US Broker, a United States based custodian service. In March 2023 Bob was entitled to a dividend of US$100.

US Broker withheld tax in the United States of US$15 (at the correct withholding rate). The platform used an approved foreign exchange source and undertook foreign exchange calculations to convert the dividend received and the amount of foreign tax credit into New Zealand dollars.

The platform provided Bob with the following information:

Foreign dividends 31 March 2023	
United States tax information	
US Co gross dividend	US$100
US withholding tax paid	US$15
US net dividend received	US$85
New Zealand tax information	
US Co gross dividend	NZ$160.51
Foreign tax credit	NZ$24.08
Net dividend	NZ$136.43

If Bob had no other income other than reportable income, he would not need to include this in an IR 3 individual income tax return, as it falls below the $200 threshold.

However, in the 2023 income year Bob earned $5,000 from taxable sales of shares and Bitcoin. Bob needs to file an IR 3 individual income tax return and include the dividend in his total overseas income, as well as the Bitcoin and share sale income as other income. He also needs to file an IR 1261 overseas income summary to account for his dividend income and foreign tax credit from a foreign company.

Taxable share sales

11. The following information explains when share sales will be taxable.

12. If you carry on a business of share dealing you will have taxable income from your business activities. Even when you don't have a share dealing business, you will have taxable income from share sales if you bought shares for the purpose of disposing of them (for example, selling them).

13. For share sales to be taxable because the shares were bought for the purpose of disposal, the purpose of disposal needs to be your dominant purpose for buying the shares. Sales will not be taxable if you had several purposes for buying the shares and sale is not the main purpose, or if you had no purpose in mind at the time you bought them.

14. A dominant purpose of disposal is more than a vague or general idea that you might sell shares in the future. For example, a sale of shares will not be taxable if you bought the shares because you wanted dividends and/or to hold the shares for a long-term investment, and you thought you might possibly sell the shares at some point in the future. You need to be able to show whether you did or did not have a dominant purpose of disposal at the time you acquired the shares.

15. While you have to show that your dominant purpose for buying shares was not to sell them, you do not have to provide a different purpose. However, share sales are not taxable if you can show that you bought shares for the dominant purpose of:

- receiving dividend income;
- receiving voting interests or other rights provided by shares; or
- a long-term investment, growth in assets or portfolio diversification (other than situations where, at the time of acquisition, this is planned to be achieved through sale).

16. When Inland Revenue is considering whether you bought shares for the purpose of disposing of them, we do this in two steps. The first step is to consider what you say your purpose was (as above). The second step is to then consider the surrounding factors to see whether they support what you say your purpose was. This includes:

- **the type of shares you bought** (for example, if the shares are volatile and speculative this could indicate you bought them for resale);
- **the length of time you held the shares** (for example, if you only held the shares for a short time before selling them this could indicate you bought them for resale, or if you held them for a longer term this could indicate you bought them for a long-term investment);
- **the surrounding circumstances of a sale** (for example, if you bought shares when the market was low and sold when the market was high this could indicate sale was your main reason for buying the shares, but if you sold the shares to fund an unexpected expense this could indicate that the sale was not your main reason for buying those shares); and
- **the pattern of activity** (for example, if you made several short-term sales of shares, this pattern could indicate that you bought the shares for sale).

17. You need to be able to show that you did not acquire shares for the dominant purpose of disposal (or, if you are claiming a loss, you will need to show that you did acquire the shares for that purpose). There is no bright-line test for share sales, so there is no set amount of time or number of trades required. It is advisable that you keep good records to support your purpose at the time you bought shares. This could include

information you obtained from the company, platform or broker when deciding what shares to buy, information on expected dividend yields (if applicable), and any lending records if you borrowed funds to invest. If you hold some shares for sale and some for long-term investment, it would be advisable for these to be held in separate accounts with your platform provider or broker.

18. The following examples illustrate some situations where share sales will be taxable and some situations where share sales will not be taxable:

- For sales to be taxable, you do not need to have a business or undertake regular trades. It is sufficient that you acquired the shares for the dominant purpose of selling them (see Example | Tauira 2 and Example | Tauira 8).
- If you bought shares to sell them but then changed your mind, a future sale is still taxable (see Example | Tauira 3).
- If you bought shares to fund or achieve something through a future sale, then you acquired the shares for the purpose of disposal and the sale is taxable (see Example | Tauira 4).

  Where your main purpose for buying shares was for dividends or a long-term investment, sales will not be taxable (see Example | Tauira 5, Example | Tauira 6 and Example | Tauira 7).

Example | Tauira 2 – Shares bought for profit on sale

In early 2024, Charlie used an online investment platform regularly.

Charlie bought and sold a few shares every now and again with an eye on sales profits. He didn't consider dividend policies, and preferred shares in companies that reinvested profits rather than paying dividends. Charlie was prepared to take risks and searched for companies on the platform by applying a "highest price change" filter. Charlie would sell shares when he considered the price was high.

The nature of the shares acquired, the length of time held and the pattern of activity indicate that Charlie acquired shares for the dominant purpose of disposal. Accordingly, the amount Charlie receives from these sales will be taxable.

Example | Tauira 3 – Change of purpose

In 2021, Olive started using an online investment platform. She used a filter to sort various New Zealand companies by the highest price change, as she was looking to earn extra money by selling shares for profit.

After a few months Olive changed her mind and decided to hold on to her shares for a long-term investment.

Two years later, Olive had a change of circumstances and had to sell the shares. Because Olive bought her shares for the purpose of selling them, the amount she receives from the later sale of the shares will be taxable. It is Olive's purpose at the time she bought the shares that determines whether sales are taxable.

Example | Tauira 4 – Purpose of sale to achieve a particular goal

Sally had funds in a term deposit that paid a low interest rate and was looking to increase the value of her investment to help fund a house deposit.

Sally was concerned that high inflation and low interest rates would mean she would be worse off once she was ready to purchase a house. When her term deposit matured, despite realising the risks involved in share investment, Sally decided to invest her deposit with an online investment platform in a combination of high growth and high dividend earning shares.

Two years later, Sally sold all her shares for profit, and had sufficient funds for a deposit on a house. Sally's main reason for buying the shares was to increase the value of her house deposit. She could achieve that only by selling the shares. Therefore, selling the shares is her dominant purpose. The gains made on the share sales are taxable.

Example | Tauira 5 – Sales to rebalance portfolio

Frankie holds a portfolio of shares on an online investment platform, with dividend yields ranging from 4% to 6%. She wants to maintain a steady income from her portfolio.

Frankie researched shares with high dividend yields on the platform she uses. Frankie discovered A Co which paid regular dividends of 6.5%.

Frankie sold shares in Y Co, which had paid dividends at the lower end of her target range. She used the funds from that sale to buy the shares in A Co.

Frankie said she originally acquired the shares in Y Co for the dominant purpose of receiving dividends, without planning to sell those shares. Her actions in selling shares in Y Co to acquire shares in A Co with a higher dividend yield support that purpose. The amount she receives from the sale of Y Co shares is not taxable.

If Frankie later sells the shares in A Co, the amount she receives from this sale will also not be taxable as she bought those shares for the dominant purpose of deriving dividend income.

Example | Tauira 6 – Sale not dominant purpose

Steve started using an online investment platform to invest in shares. He wanted to invest in ethical companies that will still provide a good return in some way.

He undertakes research before purchasing shares, focusing on the companies' ethical and sustainability policies as well as dividend history and the growth in share prices over the last few years.

At the time of purchase, Steve is not certain about how long he will hold the shares for. Two years later, he decides to sell his portfolio and sells the shares for a profit.

The sale of these shares is not taxable. Steve had several purposes for buying the shares, none of which were dominant. He could show this through his research, and what he said his purpose was is consistent with the types of shares that he bought.

Example | Tauira 7 – Shares acquired for long-term investment

Logan owned a large share portfolio that he had been adding to over the years. Some shares paid regular dividends that were re-invested, but most investments were in high growth shares that had not paid dividends (at least on any regular basis). He had recently retired and was living off his superannuation and the occasional maturity of term deposits. Logan wanted to build up his asset profile so he would have an inheritance he could eventually pass on to his children and grandchildren.

Logan did not think of his share portfolio as something he would sell, and the investments he made were consistent with that.

Logan had unexpected medical issues and sold some of his shares to fund expenses. The sale of those shares is not taxable. Logan bought the shares with the purpose of building up a portfolio that would not necessarily be sold. His change of circumstances does not alter that purpose on acquisition.

Example | Tauira 8 – Insufficient scale to be a business, but dominant purpose of disposal

Hone started using an online investment platform in November 2020. Over the next few months he enjoyed making trades and started investing more time and money into buying shares.

Hone was employed for 30 hours a week and spent his free time making trades. Hone had invested around $20,000 in the share market and used the profits from sales to supplement his living costs and re-invest in more shares.

Hone typically didn't hold shares for more than a few months, unless he thought that they would peak in value at a later time. He didn't plan to hold any shares long-term and didn't consider dividends when purchasing shares.

Hone has an intention to profit from share sales, but his level of activity, and amount of time and money spent on the share market does not indicate that he is in a business of share dealing. His level of activity does not indicate that he has an organised plan that amounts to a profit-making undertaking or scheme.

While he may not be in a business of share dealing, the amounts Hone receives from his share sales are still taxable (and losses are deductible) because the facts indicate that he acquired shares for the dominant purpose of disposal.

Claiming expenses

19. If you bought shares for the dominant purpose of disposal, at the time of sale you can claim deductions for the costs you incurred in acquiring them. This is what it cost you to buy the shares. You can also claim other costs like fees paid to the platform or broker you use and interest on amounts you borrowed to buy the shares. This means that, if you make a loss when you sell the shares, you can claim the loss in your tax return.

20. However, you can only claim a loss at the time you sell the shares. The amount of loss you can claim is the difference between the sale price and the cost of shares (and other expenses like platform fees).

21. If you claim a loss, Inland Revenue may seek more information to show that the loss was available. Depending on the circumstances, this could include information that shows you had consistently treated other profitable sales as being taxable. Example | Tauira 9 and Example | Tauira 10 illustrate when losses are available.

Example | Tauira 9 – Loss on sale of shares

In November 2021, Jimi bought $1,000 of shares in B Co using an online investment platform. He bought the B Co shares hoping to make a quick profit.

However, by the time Jimi bought the shares the market had turned. In January 2022 the shares were worth $800, and he sold them to limit the loss.

Because Jimi had bought the shares in B Co for the purpose of sale, the amount received of $800 is income. However, this income is offset by the deduction he receives for the cost of the shares and platform fees (totalling $20), which was $1,020. Therefore, Jimi made a $220 loss. He can claim this loss against his other income.

Example | Tauira 10 – Unrealised loss not deductible

Jimi from Example | Tauira 9 instead decided to hold onto his shares in B Co. By 31 March 2022, the share value had decreased further to $700.

Jimi was calculating his taxable income for the year ended 31 March 2022. However, in doing so, Jimi cannot claim the unrealised loss for the shares in B Co because he still has them. He can claim a loss only if he sold (or otherwise disposed of) his shares.

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