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INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Income tax – Share investments

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This interpretation statement provides guidance for individuals who invest in shares, so they are aware of their tax obligations. The statement covers when an investor will have a tax liability for dividends, share sales, attributing interests in foreign investment funds, share lending arrangements and foreign currency accounts. The statement focuses on investors who use online investment platforms, although the principles in the statement apply more widely to other forms of share investment by individuals (such as through brokers).

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

DRAFT

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Summary | Whakarāpopoto

1. This interpretation statement explains when individual share investors are subject to:
   - the ordinary tax rules, including when they have to return income from dividends and taxable share sales;[1] and
   - the Foreign Investment Fund (FIF) rules and must apply those rules instead of the ordinary tax rules.
2. An appendix to this statement provides further analysis on when share sales are taxable.
3. This statement applies to New Zealand tax resident individuals who invest in shares. The statement does not apply to investors who acquire interests in managed funds or Kiwisaver. Those investors will generally not have further tax liabilities, provided they have given correct information to the managed fund provider (such as their prescribed investor rate (PIR)). This statement also does not apply to illiquid investments in closely held companies.

When the ordinary tax rules apply

4. The ordinary tax rules apply to individual share investors who hold:
   - shares in New Zealand companies; or
   - shares in foreign companies and other attributing interests (that are not exempt) that together cost $50,000 or less.
5. These investors will have a tax liability in New Zealand when they receive:
   - dividends paid by New Zealand or foreign companies, to the extent that tax has not been withheld on their behalf in New Zealand by a New Zealand company or custodian;
   - amounts from selling shares, where the shares were acquired for the dominant purpose of disposal, or were part of a share dealing business or profit-making scheme;
   - fees from participating in share lending (and other amounts in situations where the share lending rules do not apply); or
   - foreign exchange gains or losses on foreign currency accounts in situations where the financial arrangements rules apply.

[1] In this statement, a reference to "ordinary tax rules" is a reference to the provisions in the Act other than the foreign investment fund rules in s CQ 4 to CQ 6 and subpart EX.

6. However, individual investors only have to include the above amounts in an IR 3 individual income tax return if the total amount of all their income that is not reportable income is more than $200 in an income year.[2]

Dividends

7. A dividend received by an investor is taxable income in New Zealand (s CD 1). This includes dividends from both New Zealand and foreign companies (including where the investor uses an offshore platform to buy foreign shares).

8. Where a New Zealand resident company pays a dividend, tax will generally have been withheld and paid on behalf of investors. Investors need to check that the amounts pre-populated in their individual income tax assessments or IR 3 individual income tax returns are correct and include any missing amounts.

9. Where a foreign company pays a dividend, tax will generally not have been withheld in New Zealand unless the shares are held by a New Zealand resident custodian on behalf of investors. Investors will need to check with their platform or broker whether tax has been withheld and paid in New Zealand. If not, the investor will need to include this income in an IR 3 individual income tax return and file an IR 1261 overseas income summary.

Taxable share sales

10. Amounts received from the sale of shares are taxable when an investor acquired the shares for the dominant purpose of disposal, has a share dealing business or the shares are part of a profit-making scheme.

11. An investor who acquires shares for the dominant purpose of disposal is subject to tax under s CB 4 when the shares are sold. When deciding what an investor's dominant purpose was at the time they acquired shares, what they say their purpose was is tested against a combination of objective factors. This includes the nature of the asset (that is, the type of shares purchased and what rights they give the holder), the length of time the shares were held, the circumstances of the purchase and disposal of the shares, and whether there is a pattern of purchases and sales suggesting there was a dominant purpose of sale.

12. An investor may have one purpose, more than one purpose, or no particular purpose for buying shares. The onus is on the investor to prove whether their dominant purpose for buying shares was to dispose of them. An investor only has to prove that

[2] Reportable income is defined in s 22D of the Tax Administration Act 1994. Essentially, it is income where tax is typically withheld by the payer, such as PAYE income payments and a payment of resident passive income (eg, interest or dividends).

disposal was not their dominant purpose; they do not have to prove an alternative dominant purpose. However, share sales will not be taxable if an investor can show that shares were bought 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).

13. For more information on when there is a dominant purpose of disposal, see from [49] and the appendix from [120].

14. There is no bright-line test for share sales, so there is no set amount of time shares are held or number of trades required for sales to be taxable. It is advisable for investors to keep good records to support their stated purpose for buying shares. This could include information obtained from the company, platforms or broker used when deciding what shares to buy, information on expected dividend yields, or any lending records if funds were borrowed to invest. Where an investor holds some shares for sale and some for long-term investment, it would be advisable for these to be held in separate accounts with the platform provider or broker.

15. An investor may also have taxable income from share sales if they have a business of share dealing. An investor will be in business if they undertake a buying and selling activity at large scale, with regular trading activity, a significant amount of time and money invested, and have an intention to make a profit (s CB 1). They may also have a share dealing business (under s CB 5) usually demonstrated through a large scale of activity, even if they do not have an intention to make a profit. Finally, an investor may also potentially have income from share sales if this is done in the course of carrying on a profit-making scheme (s CB 3).

16. When the sale of shares is taxable, investors can claim deductions for the cost of acquiring the shares, and other costs such as platform or broker fees. If the shares are sold for a loss, the investor can claim that loss. However, the loss is only available when the shares are sold (an unrealised loss cannot be claimed). When claiming a loss, investors will need to be able to show that they had acquired the shares for the dominant purpose of disposal or had a share dealing business.

Other income that may arise from the use of online investment platforms

17. Online investment platforms may give investors the opportunity to participate in share lending or hold foreign currency. These arrangements can give rise to complex tax issues.

Share lending

18. Share lending is where the investor's shares are lent to a broker, who then returns the shares to the investor at the end of the lending term. Often the investor will receive a fee for lending their shares. This fee is taxable income (s CA 1(2)).

19. There are specific share lending rules in subpart ED that apply to ensure there are no other tax consequences from entering into share lending arrangements (for example, on the disposal or acquisition of shares). However, these rules do not apply if the borrower of the shares is a foreign company and pays a dividend replacement payment. In that case, the share lending may potentially have other tax consequences. It is recommended that any investors in that situation seek advice from a tax advisor.

Foreign currency accounts

20. The financial arrangements rules in subpart EW may apply to an investor's foreign currency accounts. Where these rules apply, an investor may have a tax liability for a foreign exchange gain or loss.

21. The financial arrangements rules will not apply to an investor's foreign currency account if they qualify to be an excepted financial arrangement. This is where the total value of the balance of all the investor's variable principal debt instruments (for example, debit cards, credit cards, foreign currency accounts and revolving credit facilities) on every day in the income year is less than $50,000. This threshold includes adding together both positive and negative balances (that is, treating a negative balance as if it were positive).

22. Applying the financial arrangements rules can be complex, and it is recommended that investors who do not have an excepted financial arrangement (or who are uncertain if these rules apply to them) seek advice from a tax advisor.

When the foreign investment fund rules apply

23. Individual investors will be subject to the FIF rules in subpart EX where, at any time during the income year, they hold foreign shares and other attributing interests (other than exempt interests) that together cost more than $50,000. Investors who hold attributing interests (other than exempt interests) that cost $50,000 or less may choose to opt-in to these rules.

24. Investors who apply the FIF rules do not apply the ordinary tax rules in relation to their attributing interests that are foreign shares. Depending on the FIF method used, investors who are subject to the FIF rules may be deemed to derive a return even if they have not received any returns. Similarly, their actual returns may be ignored.

25. Applying the FIF rules can be complex, and it is recommended that investors who are subject to the FIF rules seek advice. Inland Revenue has resources available on its website to assist with calculations. See from [99] for more information.

Introduction | Whakataki

26. The use of online investment platforms to invest in shares is becoming increasingly common. This interpretation statement provides guidance for individuals who invest in shares, so they are aware of their tax obligations.

27. The statement focuses on the income tax consequences of using online investment platforms (whether the platforms are based in New Zealand or offshore). The principles in the statement would also apply more widely to individuals using other forms of share investment (such as brokers). Different rules may apply to investments made through other entities such as companies and trusts, which are outside the scope of this statement.

Part one – Application of the ordinary tax rules to share investments

28. This part explains when investors will have a tax liability under ordinary tax rules from investing in shares using online investment platforms. This part applies only to investors who hold:

- shares in New Zealand companies;
- shares in Australian companies that are exempt from the FIF rules; or
- foreign shares and other attributing interests (that are not exempt) that cost $50,000 or less, and who do not opt in to the FIF rules.

29. An investor who holds foreign shares and other attributing interests (that are not exempt) that cost more than $50,000 needs to go to part two of this statement from [99] to find out how to determine their tax liability for those interests. That part discusses when and how the FIF rules will apply.

30. This part considers when an investor will have a tax liability for:

- dividend income;
- income from taxable share sales; and
- other income arising from the use of online investment platforms (share lending and financial arrangements).

31. In several parts of this statement, the answer will depend on the platform's specific terms and conditions. It is important that investors understand the terms and conditions of the platforms they use so they know how to apply the tax rules in their situation.

Dividend income

32. A dividend is any transfer of value from a company to a shareholder (ss CD 3 and CD 4). Usually, this is a cash payment (but not always). A dividend received by an investor is taxable income under s CD 1. This includes dividends from foreign companies.

33. Although a dividend is taxable income, when it is paid by a New Zealand company it is reportable income and so tax is withheld and paid on behalf of investors by the company (or a custodian). Investors do not need to self-report this income. However, investors will need to check that the amounts pre-populated in their individual income tax assessments or IR 3 individual income tax returns are correct. It is important for investors to know when tax has not been withheld (that is, when a dividend is not reportable income) and when they are required to include that income in an income tax return. Effectively, this will occur when investors receive dividends from a foreign company, where the shares are not held by a New Zealand custodian on the investor's behalf.

Dividends received from a New Zealand company

34. When an investor receives a dividend from a New Zealand resident company, an amount of resident withholding tax (RWT) will generally be withheld and paid to Inland Revenue on the investor's behalf.

35. A dividend paid by a New Zealand company may include imputation credits, which are credits for tax the company has already paid in New Zealand. These credits are taken into account when RWT is being withheld and paid to Inland Revenue.

36. The way in which investors hold shares using online investment platforms may differ. In many cases the platform (or a separate broker or custodian) holds the shares on behalf of investors as a bare trustee or nominee. New Zealand custodians that hold investments as a bare trustee must ensure RWT has been deducted when it receives investment income that is passed on to an investor.

37. Accordingly, where investors receive dividends from New Zealand resident companies, RWT should be withheld on their behalf (by the company or a custodian). Where investors have provided the platforms with their IRD number, the relevant information will be pre-populated in their automatic income tax assessment (or will be pre-populated in their IR 3 individual income tax return if they are required to file one).

Investors should check that pre-populated amounts are correct (and if not, they will need to self-report any dividends that have been omitted).

38. The withholding of dividend income on an investor's behalf is illustrated in Example | Tauira 1.

Example | Tauira 1 – Dividends from a New Zealand company

Ari uses a New Zealand based online investment platform to buy shares in NZ Co. In the 2024 income year, Ari was entitled to a gross dividend of $100 which included an imputation credit. The platform sent Ari a tax statement showing the following information:

Tax statement 31 March 2024	
NZ Co dividend	$72
Imputation credit	$28
Taxable gross dividend	$100
RWT	$5
Net dividend	$67

Ari has a 33% marginal tax rate and their tax liability for the dividend is $33 which is satisfied through a combination of the imputation credit and RWT. This information is pre-populated in Ari's automatic income tax assessment for the year. Ari's other income in the 2024 income year was salary and interest from bank deposits (all of which have also had tax withheld and were pre-populated). Ari checks that the amounts are correct and does not need to amend the assessment or file an IR 3 individual income tax return for the 2024 income year.

Dividends received from a foreign company

39. Dividends received from a foreign company are taxable in that other country and also in New Zealand.

40. When an investor receives a dividend from a foreign company, it is likely that withholding tax will have been withheld in that other country. Some platforms will ensure that this tax is withheld at the correct rate (taking into account double tax agreements (DTAs) that apply). For this amount to be correct, investors need to provide the platforms with their IRD number.

41. For instance, if a New Zealand resident earns a dividend from a United States company and provided their IRD number to the platform, then 15% tax should be withheld in the United States on their behalf (15% being the relevant DTA rate). If the investor does not provide their IRD number, then withholding tax may potentially be withheld at the United States' withholding rate instead. Investors should check that the correct amount has been withheld on their behalf.

42. This is important because when a New Zealand resident earns dividends from a foreign company, they still have to pay tax in New Zealand. Generally, the investor will get a tax credit for the amount of foreign tax paid overseas (for example, the 15% referred to above) so they are not taxed twice on that amount. However, the amount of tax credit available is limited to the correct amount to be withheld overseas, so it is important that investors make sure the platforms have correctly applied the DTA rate. If too much tax was withheld overseas, the investor cannot claim a tax credit in New Zealand for the excess amount. More information on foreign tax credits is in IS 21/09 - **Income tax – foreign tax credits – how to calculate a foreign tax credit.**

43. Platforms deal with New Zealand tax obligations from foreign dividends in different ways. Where shares are held by a New Zealand resident custodian, the custodian withholds and pays the tax in New Zealand on the investors' behalf (taking into account foreign tax credits). However, where non-resident custodians hold shares, there is no obligation to withhold and pay New Zealand tax.

44. It should be clear from a platform's terms and conditions whether it withholds tax on behalf of investors in New Zealand. If a platform does not withhold and pay tax on dividend income in New Zealand, investors will need to self-report this information in an IR 3 individual income tax return and file an IR1261 overseas income summary to declare their overseas income sources. Information on the IR1261 overseas income summary can be found here: Reporting your overseas income.

45. Investors will need to include the New Zealand dollar value of the total amount of dividend received (calculated at the time they received the dividend). Investors cannot generally claim credits similar to imputation credits from a foreign company (such as franking credits paid by an Australian company) against their New Zealand income, but as noted above they can claim a foreign tax credit for foreign withholding tax that was paid.

46. Some platforms will provide relevant information required to do these calculations. If investors need to convert foreign currencies into New Zealand dollars, some assistance for doing this is on Inland Revenue's website at Overseas currency - conversion to NZ dollars and also see FX 21/01 - **Foreign exchange rates.**

47. An investor in this situation does not need to self-report these amounts in their IR 3 individual income tax return if the total amount of income (other than reportable income) they receive is less than $200. Reportable income is defined in s 22D of the

Tax Administration Act 1994. Essentially, it is income where tax is typically withheld by the payer, such as PAYE income payments and a payment of resident passive income (for example, interest or dividends from New Zealand companies). The $200 threshold includes all amounts that are not reportable income (such as from any taxable share sales), not just income from foreign dividends.

48. In summary, investors who buy shares in foreign companies need to carefully read the terms and conditions of the platform they use so they understand whether they are required to return dividend income in New Zealand. They also need to ensure that they have provided platforms with their IRD number and should carefully check any amounts of tax that have been withheld on their behalf and pre-populated in their assessments or returns. The requirement to return a foreign dividend in New Zealand is illustrated in Example | Tauira 2.

Example | Tauira 2 - Dividends from a foreign company

Bob uses 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 (at the correct withholding rate). The platform undertook foreign exchange calculations using an accepted method 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.

Income from taxable share sales

49. Amounts an investor receives from selling shares are taxable where the shares were:

- acquired for the dominant purpose of disposing of them;
- part of a business of share dealing; or
- part of a profit-making scheme.

Shares acquired for the purpose of disposal

50. Under s CB 4, an amount a person receives from selling assets such as shares is their income if they acquired the shares for the purpose of disposal.

51. The leading case on this provision is *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA). That case established that the purpose of sale needs to be the person's dominant purpose. What is relevant is what was most important to the person at the time of acquisition.

52. What a person says their purpose was is to be tested against the following objective factors:

- the nature of the asset;
- the length of time the shares are held;
- circumstances of the purchase, use and disposal of shares; and
- the number of similar transactions.

53. The nature of the asset concerns the particular assets that were acquired. This could involve what rights the shares confer on the holders (for example, whether the shares regularly pay or are likely to pay dividends, or whether the person receives voting interests). It may also involve considering whether the particular shares acquired are high growth or otherwise generally speculative in nature. Whether or not shares pay dividends (or there is a chance of future dividends) is one factor to consider, but it is

not determinative, and is to be weighed against the person's stated purpose and the other objective factors.[3]

54. The length of time shares are held is also important. As was stated in *National Distributors*, if shares are held for only a few months, then in the absence of any special reasons for the sale, they are likely to be viewed as being purchased for resale and taxable. If shares are held for several years, during which time the market moves upwards and downwards, then it is more likely the dominant purpose is not one of resale. However, there is no particular time period that applies to determine whether shares were acquired for disposal or not. The answer depends on the particular facts of each case.

55. The circumstances of purchase, use and disposal of shares and the number of similar transactions involves considering what the person actually did, why the shares were sold, and whether there is a pattern of activity. There is no particular number of trades required for share sales to be taxable, and as above, the answer depends on the particular facts of each case.

56. There is no requirement that the person be in business or have a purpose of making a profit. One-off sales are still taxable if the shares were bought for the dominant purpose of disposal.

57. The above concepts are illustrated in Example | Tauira 3.

Example | Tauira 3 – 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 amounts Charlie receives from these sales will be taxable.

58. It is also relevant that it is the person's purpose at the time of acquiring the shares that is important. If a person acquired shares for the dominant purpose of selling them, then later changes their mind, any subsequent sale will still be taxable. Similarly, a

[3] The Commissioner considers that generally shares differ in nature to other investment assets (such as gold bullion and cryptoassets). While the same general principles apply, the nature of the asset is given particular weight.

person who acquires shares for the dominant purpose of receiving dividends or for a long-term investment will not be taxable if they later change their mind. This concept is illustrated in Example | Tauira 4 (also see Example | Tauira 6 and Example | Tauira 9).

Example | Tauira 4 – 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.

59. A person may have one purpose for acquiring shares, several purposes for acquiring shares, or they may acquire shares without any particular purpose in mind but with a general hope that the shares will be a good investment in some way. The onus is on the investor to show that disposal was not their dominant purpose at the time they acquired shares. This is illustrated in Example | Tauira 5.

Example | Tauira 5 – 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.

60. An investor may have different purposes for different types of shares that they acquire. Different purposes can be attributed to different acquisitions of shares, although the investor will need to be able to show this. For example, it would be advisable for investors to hold shares acquired for long-term investments and shares acquired for

sale in separate accounts with their platform or broker to assist with identifying which shares are on revenue account. Different purposes for different shares is illustrated in Example | Tauira 6.

Example | Tauira 6 – Different purposes for different shares

Megan started using an online investment platform during lockdown in 2020. In April 2020, Megan purchased:

$1,000 shares in A Co; and

$1,000 shares in B Co

Megan bought the shares in A Co because they paid a dividend yield of 6.5%. She wanted an investment that earned a regular income.

Megan bought the shares in B Co, a pharmaceutical company, because she heard from her neighbour (a fund manager) that pharmaceutical companies would be good short-term investments.

Megan acquired and held the shares in A Co and B Co in separate accounts with the platform she used. In March 2021, Megan's neighbour thought the market was close to peak and Megan sold the shares in B Co for $1,800 - a gain of $800.

Later that month, Megan decided to invest into a managed fund instead, so she sold her remaining shares (A Co) for $1,100 and made a gain of $100. Megan invested all proceeds into a managed fund.

Megan made an overall gain of $900 from share sales in A Co and B Co (the amount received less the cost of the shares sold). However, she needs to return income only on the gain of $800 from selling the shares in B Co. The amount she received from the sale of shares in A Co is not taxable because she acquired those shares for the purpose of earning dividend yield (even though she later changed her mind).

61. A person can acquire shares for the dominant purpose of disposal, even if they have a wider aim in mind. As Richardson J said in *National Distributors*, if resale is proposed it does not matter that it is only the means to an end. For example, an investor may claim that shares are acquired as a store of value outside the monetary system, as a hedge against inflation, or for portfolio diversification. This does not by itself answer the question of whether the investor had a dominant purpose of disposal. There may be situations where these explanations still involve a dominant purpose of disposal that means s CB 4 applies. For more information, see the appendix from [139].

62. Also, if shares were bought for the dominant purpose of funding or achieving something through a future sale then they were acquired for the dominant purpose of disposal. This is illustrated in Example | Tauira 7.

Example | Tauira 7 – 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.

63. An investor only has to prove that disposal was not their dominant purpose; they do not have to prove an alternative dominant purpose. However, share sales will not be taxable if an investor can show that shares were bought 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).

64. Where an investor has acquired shares as a long-term investment, they will not have a dominant purpose of disposal if they have a vague or general hope that the shares will increase in value and there is a possibility they may be sold in the future.

65. These concepts are illustrated in Example | Tauira 8 and Example | Tauira 9.

Example | Tauira 8 – 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 9 - 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.

66. It can be difficult for investors to prove what their purpose was at the time they acquired assets such as shares. As noted earlier, a combination of factors is considered (including the type of asset, the investor's other activities, and how long shares are held), that can support or not support what the investor says their purpose is.

67. Where an investor says that disposal was not their dominant purpose for buying shares (for example, their dominant purpose was to receive dividends or to hold the shares for a long-term investment), they need to be able to support this. The platforms have easily accessible investment information which can be used to help support an investor's stated purpose. It is advisable for investors to keep records to support their stated purpose for buying particular shares. This could include information obtained from the company, platforms or broker used when deciding what shares to buy, information on expected dividend yields, or any lending records if funds were borrowed to invest. Where an investor holds some shares for sale and some for long-

term investment, it would be advisable for these to be held in separate accounts with the platform provider or broker.

Summary of s CB 4

68. In summary, the Commissioner considers that the following principles apply when determining whether s CB 4 applies to the sale of shares:

- The relevant purpose is the person's dominant purpose at the time shares are acquired.
- A person's stated purpose for acquiring shares will be weighed against objective factors to determine the dominant purpose of acquiring the shares. The two main factors considered are the nature of the asset and the length of time the shares are held. Other factors include reasons why the shares were sold, and the other activities undertaken by the person (such as whether there is a pattern of buy/sell activity).
- Where the objective factors show that a person acquired shares with the dominant purpose of disposing of them in some way, then s CB 4 will apply. This will include a person looking for a short-term gain, and also a person who bought shares with the dominant purpose of sale, even though sale is planned in the longer term.
- Where shares are acquired for some other dominant purpose (for example, receiving dividends, a long-term investment or receiving voting interests) the subsequent sale of those shares is not subject to s CB 4. This may be clear from the facts, or the dominant purpose can be determined by considering the person's stated purpose in light of the objective factors set out in *National Distributors*.
- Where a person acquired shares for more than one purpose (for example, dividends and gains on sale), the factors from *National Distributors* can be applied to determine which purpose is dominant. If it is not clear that sale was the dominant purpose, then s CB 4 will not apply.
- If the person does not have any particular purpose in mind and can show that disposal was not their dominant purpose, s CB 4 will not apply.

69. For more information, including a detailed discussion of the relevant case law, see the Appendix from [119].

Business of share dealing

70. An investor who buys and sells shares on a large scale is in a business of share dealing for the purposes of s CB 1 where there is a combination (or all) of the following factors:

- a high scale of regular activity (buying and selling);
- an intention to profit from share sales;
- regular or continuous monitoring of the share portfolio;
- there is a system according to which shares are bought and sold;
- sales are frequent and part of the person's normal operations in the course of making profits;
- large amounts are invested; and
- the person spent a significant amount of time in the dealing activity.

71. The courts have noted that there is a high bar to be in a business of share dealing – there needs to be a sufficient amount of activity, time and money invested and the requisite intention to profit. To summarise, the following factors were relevant to a finding by the courts that there was a business of share dealing:

- share sales were an integral part of the business, and part of the normal operations of the business;
- there was regular or continuous monitoring of the share portfolio, and a system according to which shares were sold;
- sales were frequent, and both sales and purchases are made on a large scale; and
- a large amount of money was invested.

72. More information on whether an investor has a share dealing business is from [156].

73. An investor with a large scale dealing activity may alternatively have a share dealing business for the purposes of s CB 5. Under this provision, the main difference is that the person does not need to have a profit-making intention. They still need a large scale of buying and selling activity and a significant amount of time and money invested.

Profit-making undertaking or scheme

74. Share dealing activity that is part of an organised plan to derive profit from a scheme of dealing in shares may be a profit-making undertaking or scheme for the purposes of s CB 3. There must be a sufficiently formulated plan in existence. Although potentially applicable to investments in widely held shares acquired through platforms or brokers, this would be unusual. However, if applicable, any profits are only taxable from the time of entering the scheme.

75. Relevantly, and as previously discussed, even if there is not a business or a profit-making scheme in existence, investors will be taxable on their share sales when they

are undertaking dealing activities, where the shares were acquired for the purpose of disposal.

76. Example | Tauira 10 illustrates a situation where an investor is not in a share dealing business but has a purpose of disposal.

Example | Tauira 10 – 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

77. No costs or expenses can be claimed where an investor's share sales are not taxable.

78. Where an investor has taxable share sales, they can claim a deduction for the cost of buying the shares. This deduction is available in the income year in which the shares are sold. Investors can also claim other costs like fees paid to the platform or broker and interest incurred on amounts borrowed to fund the purchase of the shares.

79. If an investor cannot trace the cost of specific shares sold, they can apply either the first in first out, or weighted average cost methods for determining cost (s ED 1(5)). They cannot use other methods for determining the cost of shares.

80. Where such an investor sells the shares for less than what they cost, they can claim that loss. However, the amount of loss relates only to the difference between the sale price and the cost of the shares (and other expenses like platform fees). It does not apply to

any unrealised losses (for example, if the shares had gone down in value but the investor still owns the shares).

81. When a loss is claimed, the Commissioner may seek information to show that shares were held on revenue account. Depending on the circumstances, this could include ensuring investors had consistently treated any profitable sales as being taxable.

82. Example | Tauira 11 and Example | Tauira 12 explain when losses are available.

Example | Tauira 11 – 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 is offset by the deduction he receives for the cost of the shares and other expenses like 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 12 – Unrealised loss not deductible

Jimi from Example | Tauira 11 instead held 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 losses 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.

Other income from the use of online platforms

83. In addition to receiving income from dividends and selling shares, online investment platforms may give investors the opportunity to:
    - participate in share lending; and
    - hold foreign currency.

84. These arrangements can give rise to complex tax issues.

Share lending

85. Some online investment platforms offer share lending (sometimes referred to as stock or securities lending) of shares with United States brokers or custodians. Investors should carefully read the terms and conditions when signing up to platforms and seek advice before agreeing to participate in these arrangements.

86. Under general principles, investors who share lend would be treated as having sold their shares and then having reacquired new shares. This can have tax implications. However, there are share lending rules in subpart ED that mean that in certain circumstances the sale and reacquisition of shares are ignored so there are no tax consequences.

87. Where an investor participates in share lending with foreign companies, the share lending rules will apply as long as no dividends are paid by the foreign company (and no dividend replacement payments are paid by the foreign borrower) during the term of the loan. This means investors will not have New Zealand tax consequences as a result of entering into these lending arrangements. Investors will still need to pay tax on any fees they receive. This is illustrated in Example | Tauira 13.

88. However, if a dividend and dividend replacement payment is payable during the term of the loan by a foreign company, the share lending rules will not apply. In that event, investors should consult a tax advisor to determine their tax obligations.

Example | Tauira 13 – Share lending arrangement

Cheng signed up to use an online investment platform. He noticed in the terms and conditions that by signing up he had agreed to participate in share lending with the US custodian who held the shares on his behalf.

In September 2022, Cheng was notified that shares he held in US Co had been subject to share lending by the US custodian. US Co rarely paid dividends, so Cheng did not receive any dividend replacement payments during the term of the loan. Cheng received a percentage of the fees from the lending arrangement.

Cheng is liable for tax only on the fees he receives from the lending arrangement. However, if a dividend replacement payment was paid, the share lending rules would not apply. In that case, Cheng would be treated as having sold and then reacquired the shares. Cheng may wish to consult his tax advisor to work out his tax obligations.

Foreign currency accounts

89. Investors may hold foreign currency in their accounts with a platform (or with their brokers or custodians). This may be necessary if the investor:

- receives a dividend in a foreign currency;
- wishes to buy shares in a foreign currency and converts New Zealand dollars into that currency; or
- uses a platform that automatically converts New Zealand dollars into other currencies.

90. When the value of the foreign currency changes compared to the New Zealand dollar, investors may experience foreign currency gains or losses. Investors will need to take account of these gains or losses if the financial arrangements rules in subpart EW apply to them.

91. The financial arrangements rules will not apply to an investor's foreign currency account if they qualify to be an excepted financial arrangement. This is where the total value of the balance of all their variable principal debt instruments on every day in the income year is less than $50,000 (this includes both positive and negative balances). A "variable principal debt instrument" is an account that allows an investor to advance or repay amounts at their call, and includes foreign currency accounts, savings or debit accounts, revolving credit facilities and credit cards.

92. If an investor has a balance of more than $50,000 across all these types of accounts they hold on any day of the income year, they will need to apply the financial arrangements rules to calculate their foreign exchange gain or loss. Some investors who are subject to the financial arrangements rules may be a cash basis person and will not be required to spread their income or expenditure over time. However, these investors still need to calculate their foreign currency gains or losses under these rules when they convert foreign currency into New Zealand dollars.

93. For more information on variable principal debt instruments and cash basis person requirements, see:

    - IS 22/05 **Cash basis persons under the financial arrangements rules;** and
    - IS 20/07 **Application of the financial arrangements rules to foreign currency loans used to finance foreign residential rental property**

94. Applying the financial arrangements rules is complex, and it is recommended that investors who are subject to the rules seek advice from a tax advisor.
Example | Tauira 14 illustrates when an investor has an excepted financial arrangement.

Example | Tauira 14 – FX account subject to financial arrangements rules

Jorge held a portfolio of United States shares through an online investment platform. The platform automatically converts Jorge's New Zealand dollar deposits into United States dollars held in his account.

On 1 April 2023 Jorge deposited US$500 funds in his platform account. This was the equivalent of NZ$799.

Jorge also had $20,000 in a bank deposit account, owed $2,000 on a credit card and owed $25,000 on a revolving credit facility.

Jorge has less than $50,000 across the balances of his variable principal debt instruments. This means he does not need to calculate any foreign exchange gains or losses in his foreign currency account.

However, if Jorge exceeds the threshold, he should seek advice from a tax advisor.

Transitional residents

95. Special rules apply to transitional residents. These are people who have moved to New Zealand for the first time or who have returned after being resident elsewhere for 10 years or more.

96. The period that a person is a transitional resident is essentially four years from when they become resident in New Zealand. During that time, transitional residents are liable for tax in New Zealand only on their income that is sourced here. Income that would be sourced in New Zealand in relation to share investments using online investment platforms could include:

    - dividend income from shares in New Zealand companies;
    - income from taxable sales of shares in New Zealand companies; and
    - income from a business of share dealing carried on in New Zealand.

97. This means transitional residents have no tax liability in New Zealand for any dividend income received from a foreign company, or sales of shares in foreign companies (unless the person is carrying on a business in New Zealand). This is illustrated in Example | Tauira 15.

Example | Tauira 15 – Transitional resident

Mikah moved to New Zealand three years ago and is a transitional resident for tax purposes. Mikah had a United States share portfolio worth NZ$60,000. He also used an online investment platform to buy shares in NZCo and earned regular dividends.

During his transitional residency period, Mikah is subject to tax in New Zealand on the dividends received from NZCo, as dividends from a New Zealand resident company are sourced here. Mikah is not subject to tax in New Zealand on any dividends received from

foreign shares. He is also not within the FIF rules (which do not apply to transitional residents).

Before he reaches the end of his transitional residency period, Mikah should discuss the implications of his share portfolio with a tax advisor. For example, Mikah may become subject to the FIF rules once the transitional residency period ends.

Part two – Application of the foreign investment fund rules to share investments

98. The above discussion of the ordinary tax rules applying to share investments does not apply if the FIF rules apply. The FIF rules are a special set of rules contained in subpart EX and in ss CQ 4 to CQ 6 and DN 5 to DN 9, that apply to particular investment interests. This part explains when an individual investor will be in the FIF rules.

99. It is important for investors to be aware that this regime exists. It is also important to note that the FIF rules apply across all relevant investments that are subject to the FIF rules and not just to foreign shares. If an investor is not in the FIF rules, this does not mean that their foreign share investments are not taxable, as explained in part one of this statement.

100. The FIF rules are complex and applying them is fact specific. This statement provides a summary of when the FIF rules apply where the investment is in foreign shares. If an investor thinks they may fall within these rules, more information on applying the FIF rules can be found in the following resources:

- Inland Revenue's booklet on the FIF rules IR461-Guide to Foreign Investment Funds
- Inland Revenue's website at Foreign investment funds (FIFs)
- QB 23/10 **Foreign investment fund (FIF) calculation methods in cases of non-compliance**

When the FIF rules apply to investors who hold foreign shares

101. The FIF rules apply where a person holds an attributing interest in a FIF that is not exempt. An attributing interest in a FIF is an investment that includes:

- direct income interests in a foreign company;
- an interest in a foreign superannuation scheme (other than Australian regulated superannuation schemes as explained in s EX 33); and

- rights to benefit under a life insurance policy issued by a FIF.

102. A person has a direct income interest in a foreign company if they hold:

- shares in a foreign company;
- shareholder decision-making rights for a foreign company;
- a right to receive or apply a foreign company's income for the relevant period; or
- a right to receive or apply any of the value of a foreign company's net assets if they are distributed.

103. However, the FIF rules do not apply to interests that are exempt. Exempt interests relevantly include shares in New Zealand companies and in certain Australian ASX listed companies and Australian unit trusts.[4] To find out if an Australian company is exempt from the FIF rules, see Foreign Investment Fund Australian listed share exemption tool. There are also other exemptions listed in subpart EX. These interests are not included as attributing interests in a FIF, because they are exempt. However, the general rules discussed in part one of this statement would apply to those shares. To find out more about exempt interests see the table at page 6 of IR461-Guide to Foreign Investment Funds.

104. Therefore, when a New Zealand resident individual buys shares in foreign companies (other than exempt interests), they will hold a direct income interest in a foreign company. This means that they hold an attributing interest in a FIF.

105. An individual has FIF income in a year if the total cost of all their attributing interests in FIFs that they hold at any time during the year (that are not exempt) is more than $50,000. An investor who holds attributing interests (other than exempt interests) that cost them $50,000 or less may still choose to opt in to the FIF rules. The test for this threshold to apply is what the shares cost the investor to acquire, not their market value on any day.

106. If an investor jointly owns attributing interests with a partner or spouse, their share of the cost of those interests is included in the calculation. The cost of the investors share of the joint holdings is added to the cost of any attributing interests they may separately hold.

107. An investor will not have FIF income if they are a non-resident or a transitional resident.

[4] An exempt share in an ASX listed Australian company is one that is not stapled to another share, the company is Australian resident and is not also resident in another country, is included on the official list of ASX Limited and maintains a franking account. An exempt Australian unit trust is also Australian resident and not also resident in another country, has a RWT proxy and the trust meets a certain amount of share turnover and distributions. Where these requirements are not met, the relevant company or unit trust will be a FIF. See ss EX 31 and EX 32 for more information.

108. An investor who is in the FIF rules will need to include FIF income in their IR 3 individual income tax return and file an IR1261 overseas income summary to declare their overseas income sources. For more information see Reporting your overseas income (ird.govt.nz).

109. In some situations, investors also need to file a FIF disclosure. However, generally, individuals who hold less than 10% of the interests in a foreign company that is incorporated in a country that has a double tax agreement with New Zealand (for example, the United States) and who use the FDR or CV methods (discussed below) are exempt from needing to file a FIF disclosure.[5]

110. If an investor is not required to apply the FIF rules and has not opted into the FIF rules, the ordinary tax rules discussed in part one will apply.

How tax is calculated when the FIF rules apply

111. The FIF rules apply to attribute income to an investor – so even if an investor has not received any returns or gains, they may be treated as if they had. Similarly, any actual returns or gains they receive may be ignored, depending on the FIF method applied.

112. FIF income for an investment is calculated using one of five methods chosen by the investor (subject to some limitations). These methods are the:

- fair dividend rate (FDR) method;
- comparative value (CV) method;
- cost method;
- attributable FIF income method; or
- the deemed rate of return method.

113. A method is chosen by the investor returning in their tax return a relevant amount of income using one of the methods.

114. There are restrictions on the method that can be chosen in certain situations. For an explanation of the methods that may be used and how to calculate an investor's FIF income, see the table at page 11 of the IR461 Guide to FIFs and the explanation from page 14.

115. In very brief summary, the method most commonly used is the FDR method. A person who uses the FDR method is generally taxed on 5% of the opening market value of their shares (or other attributing interests). Dividends and gains from the sales of shares are usually not taxed under this method. However, when there is a "quick sale"

[5] See the relevant International Tax Disclosure Exemptions issued for each income year.

(that is, shares are bought and sold within a year) then a quick sale adjustment is required. This is explained in more detail in the IR461 Guide to FIFs at page 15.

116. Another option for an individual investing in ordinary shares is the CV method. Under this method, the investor calculates the closing market value of the shares plus any gains (including dividends and gains from sales) and subtracts the opening market value plus costs.

117. Individuals can do the calculations under either of these methods and choose which one they would prefer to use, in each income year. A calculation tool is provided on Inland Revenue's website to do this: Calculate my foreign investment fund income. The application of the FIF rules to an investor using an online investment platform is illustrated in Example | Tauira 16.

Example | Tauira 16 – Attributing interests in a FIF exceed $50,000 in a year

Jax came into a windfall when their uncle left them $55,000 in a will. On 31 March 2022, Jax decided to invest this amount in ordinary shares in a variety of United States companies using an online investment platform.

Jax will be subject to the FIF rules because at a point in time in the 2022 income year Jax held attributing interests that had cost over $50,000. However, under the FDR method no income will arise as the opening value on 1 April 2021 was zero.

For the 2023 income year, Jax had not sold any shares, and uses Inland Revenue's calculation tool to work out their FIF income. Jax works out that under the FDR method they have deemed income of $2,750 (opening market value of $55,000 multiplied by 5% with no quick sale adjustments).

As a natural person, Jax can compare the result under the FDR method with the CV method and choose which method to use. As at 31 March 2023, the value of Jax's shares had increased to NZ$59,125. Jax had received no dividends and made no sales. Under the CV method, Jax's FIF income would be $4,125 ($59,125 - $55,000). Jax chooses to use the FDR method. Jax can make this choice again in the following income year if the FIF rules still apply.

Jax will need to complete the IR 1261 overseas income summary but does not need to file a FIF disclosure.

Appendix – Further analysis and case law

118. This appendix provides further analysis and case law that explains why the Commissioner has reached views in part one. The following analysis provides a detailed explanation of the case law on when an investor has:

- acquired shares for the purpose of disposal; and
- a share dealing business or profit-making scheme.

Shares acquired for the purpose of disposal

119. As noted in part one, the leading case on s CB 4 is *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA). In that case, Richardson J said at 6,350:

> … It is well settled that the test of purpose is subjective requiring consideration of the state of mind of the purchaser as at the time of acquisition of the property. … Where there is more than one purpose present taxability turns on whether the dominant purpose was one of sale or other disposition… The analysis may become more complicated where different purposes may be more significant depending on whether the focus is on the short term, the medium term or the ultimate object. Adoption of a dominant purpose test in relation to the particular property purchased allows a sensible focus as a practical matter on what was truly important to the taxpayer at the time of acquisition.

120. What is relevant is what was truly important to the taxpayer at the time of acquisition.

121. Richardson J referred to investment assets (such as shares) and said that generally speaking, a person buying such an asset does so either with a view to investment for the income it will return or with a view to realising a profit on disposal. He noted that although these purposes are not mutually exclusive "it will generally be possible to say that the one or the other is predominant at the time when the purchase is made". His Honour went on to say at 6,352:

> If the investment policy is to provide and enlarge the dividend income and to buy (and sell) with that as the dominant consideration, there can be no basis for invoking [s CB 4]. It is proper then to distinguish between sales made in the course of the review of an investment portfolio held primarily for its potential income yield on the one hand, and sales of shares acquired primarily with the object of eventually realising gains on resale on the other. Many ordinary investors acquire shares for the purpose of securing not only income from dividends, but also growth in the value of the shares. In those cases where there is not a clear dominant purpose of resale at the time of purchase, any profits on the ultimate sale of the shares are not within [s CB 4].

122. However, where property is acquired with no particular purpose, but the taxpayer has a vague or general hope that the property will increase in value, that does not amount to a purpose of disposal. Richardson J stated at 6,352:

> Up to this point I have been discussing the identification of the purpose or purposes of the purchase. However assets may be acquired by a taxpayer who has no clear purpose in mind. There may be no more than an intention to buy with the expectation of benefiting the taxpayer's financial position in some unformulated way, and without any clear consideration of the advantages of either retention or resale sooner or later. If that state of affairs is established the statutory onus on the taxpayer to prove that the shares were not purchased for the dominant purpose of sale will have been satisfied. To put it another way, to discharge the onus it is not necessary to establish some other specific purpose.

123. Similarly, Casey J stated at 6,355:

> The taxpayer will also succeed if property is acquired without any definite purpose in view at all, or merely in a vague general hope that it would be a good investment — see *Williams Property Developments* at NZTC pp 61,541-61,542; NZLR pp 283-284.

124. Similar comments were also made in *G Williams v FCT* 74 ATC 4237 and *Case V3* (2001) 20 NZTC 10,021.

125. Dobson J in *CIR v Boanas* (2008) 23 NZTC 22,046 (HC) draws a distinction between a formulated purpose to do something at a future time, and a mere prospect, option or aspiration regarding something that may happen in the future (which is not enough to amount to a purpose of disposal). This decision concerned the land provisions rather than s CB 4 (which has a different test for when a person has a purpose of disposal) but highlights that for a person to have a "purpose", it must be sufficiently formulated.

126. The above comments indicate that a person may acquire property without any particular purpose in mind. In such a case, the person will still need to be able to show that disposal was not their dominant purpose (and, for instance, the objective factors referred to in part one may support their statement or indicate otherwise).

127. The above comments also show that a person may have a dominant purpose of disposal if it is sufficiently formulated, even if that purpose will not be actioned until a future time.

128. In *National Distributors*, the taxpayer made eight purchases and sales of shares over a two-year period. The shares were held between eight months and three years, with an average of 19 months before sale. The dividend yields were inconsistent and ranged from less than 3% to over 11% per year depending on the shares. Overall, the dividend yield was 6.5% per year compared with 25% per year from gains on sale.

129. Richardson J found the shares fell into two categories. Some were purchased for family or other reasons and not the usual commercial reasons of obtaining a return

from dividends or proceeds of sale. However, Richardson J found the taxpayer did not establish that the shares in the second category "were not acquired for the dominant purpose of sooner or later reselling them". Richardson J's reasons on the facts of that case were:

- Despite the taxpayer contending that its dominant purpose was dividend yield, no consideration was given to the dividend potential at the time of purchase and there was no policy for a particular level of dividend return.
- The shareholdings could not fairly be described as being held long term (between 8 months and 3 years).
- The taxpayer's practice was to sell shares when it appeared they had reached their peak prices (which was indicative of a focus on achieving the maximum market price rather than on enlarging the dividend potential).
- While there may have been a purpose of obtaining a dividend return, the dominant purpose was to realise a profit on disposal sooner or later when the shares reached their full market potential.

130. The objective factors discussed in part one at [51] can be applied in the context of the above facts the court referred to when concluding the dominant purpose of acquiring the shares was disposal:

- the nature of the asset – there was no consideration of dividend yield when acquiring shares;
- the length of time the shares were held – could not be described as long term (being 8 months to 3 years);
- the circumstances of sale - the taxpayer sold shares when they appeared to reach peak prices; and
- the number of transactions - there was a pattern of activity of selling shares when they were judged to have met their full market potential.

Purpose means the object the person has in mind

131. Several cases have considered the difference between a person's purpose (which is relevant for s CB 4) or their motive or intention (which is not relevant).

132. In *Plimmer v CIR* [1958] NZLR 147 (SC) Barrowclough CJ said a person's purpose is usually the object that they have in mind. In *Plimmer,* the taxpayer sought to acquire control of a company, by purchasing all of the company's issued ordinary shares. A condition of the purchase was that they had to buy all the company's preference shares. The unwanted preference shares were purchased, and the taxpayer then on-sold the preference shares, making a profit. This sale was found not to be taxable

because the purpose or object of acquiring the preference shares was to acquire the ordinary shares (and control of the company).

133. In *CIR v Walker* [1963] NZLR 339 (CA) the taxpayer purchased land adjacent to his farm. At the time of purchase the taxpayer did not want three acres of the land that had a long road frontage and wanted to subdivide those three acres off while adding the rest of the land to his farm. Although the taxpayer wanted to sell three acres of the acquired land, the Court accepted that the dominant purpose had been to purchase the 60 acres to increase the size of farmland.[6]

134. *In CIR v Hunter* [1970] NZLR 116 and *Holden v CIR; Menneer v CIR* [1974] 1 NZTC 61,146 (PC), the taxpayers received United Kingdom currency and wanted to convert it into New Zealand dollars. The taxpayers purchased shares and sold the shares for New Zealand dollars. This way, the taxpayers received more New Zealand dollars than they would have received through transfers in the banking system. The courts held the taxpayers' dominant purpose in acquiring the shares was to immediately sell them (even though there was a reason for doing this – to receive more New Zealand dollars than through the banking system).

135. In relation to this issue, Richardson J in *National Distributors* said at 6,351:

> **In short, if resale is proposed it matters not that it is only the means to an end**. ... To describe a purchase as a hedge against inflation or as providing an accretion in capital value, or as a good investment, is not a substitute for embarking on the enquiry required under ... [s CB 4]. Such expressions do not provide a cloak of tax immunity. In its ordinary meaning to make an investment is to outlay money in the purchase of anything from which profit is expected, whatever form it takes; and to provide a hedge against inflation or an accretion in capital value are the underlying motives for engaging in transactions. **It is still necessary to determine whether the dominant purpose of the taxpayer in acquiring the property was to sell it at a future date.** As *Holden* and *Hunter* demonstrate, the reason why the taxpayer decided to buy with a view to selling in due course is not relevant to the statutory enquiry. If the taxpayer's dominant purpose in acquiring the property is to sell it in the future at a price which, allowing for inflation, corresponds with or is better than its price at the time of purchase, his statutory purpose is to sell the property even though his motive is to protect his savings from inflation. [Emphasis added]

136. Specifically, Richardson J commented that it did not matter whether resale is only the means to some wider aim. Richardson J commented that reasons for purchasing shares such as hedging against inflation, or being a good investment, are not relevant to the enquiry into a person's purpose. These are broad expressions and do not reflect the underlying purpose of the person in acquiring those assets. What is relevant is

[6] This case concerned a legislative provision that had previously included land and personal property in the same provision. These are now separate provisions with different tests, and so cases on land are now of less relevance to s CB 4.

whether the property had to be sold to give effect to the relevant aim. The reasons why that may occur are not relevant.

Examples of reasons investors may have for buying shares

137. A person may acquire shares for a variety of reasons, such as:

- dividend income;
- a long-term investment;
- a hedge against inflation;
- a store of value outside the banking system;
- portfolio diversification;
- to obtain voting interests or other rights arising from being a shareholder; or
- other reasons (eg, family reasons or for no particular purpose).

Long-term investment, hedge against inflation and portfolio diversification

138. As is noted above in *National Distributors*, many of the motives that an investor may have for buying shares do not explain whether their dominant purpose is to dispose of them. Richardson J noted there may be cases where a person's purpose is the retention of an asset for reasons such as building up a large estate or securing the real value of the person's money for the long term. What is relevant is whether their motive is given effect by disposing of the shares. Richardson J indicated that descriptions such as acquiring property as a long-term investment or hedge against inflation will not negate a dominant purpose of disposal if disposing of the property is required to give effect to that motive. As noted above he said:

> **To describe a purchase as a hedge against inflation or as providing an accretion in capital value, or as a good investment, is not a substitute for embarking on the enquiry required** under … [s CB 4]. **Such expressions do not provide a cloak of tax immunity.** In its ordinary meaning to make an investment is to outlay money in the purchase of anything from which profit is expected, whatever form it takes; and to provide a hedge against inflation or an accretion in capital value are the underlying motives for engaging in transactions. [Emphasis added]

139. Therefore, where an investor says they bought shares because it was a good investment, a hedge against inflation or for portfolio diversification, it is still necessary to determine whether their dominant purpose was to sell at a future date (and the reasons for such a sale are not relevant).

140. As *Holden* and *Hunter* demonstrate, the reason the taxpayer decided to buy with a view to selling in due course is not relevant. If a person's dominant purpose in

acquiring shares is to sell them in the future at a price that, allowing for inflation, corresponds with or is better than the price at the time of purchase, the purpose is still to sell the shares even though the motive might be to protect savings from inflation.

141. Several Australian cases have looked at whether property purchased as a hedge against inflation was purchased for a purpose of profit-making by sale. It is important to note that many of these cases turn on whether the taxpayer had a profit-making purpose, which is relevant to the Australian test that applied at the time. A profit-making purpose is not needed for s CB 4 to apply.

142. In *FCT v Firstenberg* 76 ATC 4141 (SC of Vic) the court considered that investing in an appreciating asset does not of itself mean it was acquired for the purpose of profit-making by sale. For instance, the taxpayer could acquire an appreciating asset to secure the value of their money so as to have that asset fall part of their estate.

143. *Firstenberg* highlights that merely describing property as being acquired as a hedge against inflation does not determine what the person's purpose was. The purpose may be to retain an asset for a long-term investment or to pass on to heirs, or it may be to sell the asset.

144. In another Australian case, *Case P27* 82 ATC 117 the Board of Review held that while the taxpayer's motive in acquiring bullion was a hedge against inflation, his dominant purpose was to sell it at a profit when he reached age 55. Member Harrowell stated at 122:

> ... It seems to me that where the property was acquired "for the purpose of profit-making by sale" that fact cannot be obscured by a throw-away phrase such as "a hedge against inflation". In fact I believe that that phrase is actually detrimental to this taxpayer's case as it clearly indicates an intention or purpose to make a profit. Such a phrase may not be detrimental where a taxpayer can show that when he purchased the property he had no intention of later reselling it at a profit. Naturally to become involved with sec. 26(a) he must later sell that property or part of it so that the facts surrounding the sale will become most relevant to his case. This situation can also arise where a taxpayer claims that the sale is part of a transposition of investments. The word "transposition" is no tax cure-all and if called upon, the taxpayer must show in terms of sec. 190(b) that the investments were not acquired for the purpose of profit-making by sale or from the carrying out of any profit-making undertaking or scheme. *London Australia Investment Co. Ltd. v. F.C. of T.* 77 ATC 4398.

145. Therefore, there may be circumstances where assets acquired as a hedge against inflation are not purchased with the dominant purpose of disposal. However merely describing property as being acquired as a hedge against inflation is not sufficient to negate a dominant purpose of disposal.

146. Similar arguments to the above may also be made that shares are acquired as a store of value outside the monetary system or for portfolio diversification. Again, as with the

above discussion, there may be situations where this stated reason involves no dominant purpose of disposal. But there may also be situations where there is still a dominant purpose of disposal that means s CB 4 applies.

Other reasons for buying shares

147. People may buy shares for other reasons. For example, there may be private or family reasons for a purchase, shares may be acquired for voting rights, or a person may not have any particular reason in mind.

148. *Rangatira Ltd v CIR* (1994) 16 NZTC 11,197 (HC) involved an investment company that administered the assets of charitable trusts. The taxpayer's investment policy involved considering capital maintenance and regular dividends and, from time to time, investments changed in accordance with that policy. During the relevant years substantial gains were made on the sale of shares. The higher court decisions concerned whether sales were income from a business, but the High Court decision touched on whether the equivalent to s CB 4 applied.

149. The High Court noted there was no purpose of disposal where shares were acquired:

- because of an association with another company (the taxpayer had been a long-term shareholder of such a company and acquired further shares during a rights issue);
- because a member of the taxpayer had joined the board of the company;
- for long-term holding consistent with the taxpayer's investment pattern (eg, shares in particular industries were acquired in line with the investment policy); or
- with evidence the taxpayer had obtained advice about long-term investments.

150. In *CIR v National Insurance Company of New Zealand Ltd* (1999) 19 NZTC 15,135 the Court of Appeal noted the fact that at the time of purchase a taxpayer did not expect to hold the property forever and contemplated the possibility of sale is not enough to fall within s CB 4. The Commissioner had submitted that because the known dividend yield was small, resale to reap the true benefits of the purchase must have been intended. Although this was a factor to be given weight, the court considered this was not enough of itself. The shares in question were a large shareholding in a company with only one other shareholder, so gave the taxpayer representation on the board. Nothing indicated that sale was a predominant consideration in acquiring those shares.

151. Shares may be acquired for the dominant purpose of receiving voting rights. Where shares are bought using platforms, the scale of investment may generally be too low or relevant voting rights may not pass through to the investors. However, an investor may be able to show otherwise.

152. A person may also have no dominant purpose in mind for buying shares. This was seen in *Case P24* (1992) 14 NZTC 4,174 (TRA) where the taxpayer owned a portfolio of shares and made profits from the sale of some of the shares. The taxpayer stated the shares were a form of investment for her retirement, to make provision for her grandchildren, and to hedge against inflation which had been eroding the value of her savings. When she sold shares, this was generally to meet expenditure as it arose. Judge Willy noted that she had disparate and competing purposes. They included, on the evidence, that she was investing for the future; that she wished to conserve the value of her money; that she was saving for her retirement in the expectation of receiving a small income; and that she wanted security for her future, for example, for emergencies around the house or the possibility of an overseas trip. Judge Willy was satisfied on the totality of the evidence that she had no single dominant purpose and in particular no dominant purpose of sale.

153. It is relevant that the treatment of investment assets such as shares differs to other assets that a person can use and enjoy, such as land, fine art or collectors' pieces. Land is subject to different provisions, which do not require disposal to be the dominant purpose. However, the test for land sales being taxable under s CB 6 can be difficult to apply as land can have many uses and purposes to which it may be put by an owner. For example, land can be lived on, farmed, rented, leased, or used for a business or other activity. In comparison, as Richardson J noted in *National Distributors,* investment assets (such as shares) generally have two purposes - gain on sale or income from dividends (although other purposes may also exist).

154. For completeness, a purpose of disposal requires a purpose by way of sale or similar and does not include a purpose of gifting (for example by way of inheritance).[7]

Business of dealing in shares

155. Section CB 1 provides that an amount that a person derives from a business is their income. Section YA 1 defines a business as including any profession, trade, or undertaking carried on for profit.

156. The leading New Zealand case on whether a business is being carried on is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). In *Grieve*, Richardson J concluded that both the nature of the activities and the intention of the person in engaging in these activities are important in determining whether they are carrying on a business. Richardson J set out matters that are relevant for deciding whether a business is being carried on:

- whether the person has a profit-making intention;
- the nature of the activity;

[7] See QB17/08 **Are proceeds from the sale of gold bullion taxable?**

- the period over which the activity is carried on;
- the scale of the operations;
- the volume of transactions;
- the commitment of time, money and effort;
- the pattern of activity;
- financial results; and
- whether the activities are carried on in a similar manner to other similar businesses.

157. There is a difference between carrying on a business and simply realising an investment (*Californian Copper Syndicate (Limited and Reduced) v Harris (Surveyor of Taxes*) (1904) 5 TC 159).

158. Several cases specifically consider whether investors who are buying and selling shares are carrying on a business of dealing in shares. In *National Distributors Ltd v CIR* (1987) 9 NZTC 6,135 the High Court considered the taxpayer was not in a share dealing business (this issue was not challenged on appeal, and the Court of Appeal decision is discussed in relation to s CB 4 above). Relevant factors included whether:

- share sales were an integral part of the business;
- there was regular or continuous monitoring of the share portfolio;
- there was any system according to which shares were sold;
- sales were frequent and part of the person's normal operations in the course of making profits; and
- the sales and purchases were made on a large scale.

159. In *National Distributors*, the share sales were intermittent, unsystematic and made in relation to inflationary trends. However, most of the share sales still ended up being taxable for a different reason (as discussed in relation to s CB 4 above).

160. In *Estate of King v CIR* [2007] NZCA 474, a New Zealand resident family used an agent in England to manage their share portfolio. The agent was tasked with earning a specific income on the portfolio each month. The Court of Appeal found the taxpayers were not carrying on a business of trading in shares because:

- the nature of the activity was investment;
- the scale of the activity was not large enough (131 transactions made during a three-year period);
- specific reasons were provided for some transactions, which suggested they were not part of a plan or a regular pattern of share trading; and

- the intention was not to conduct a business.

161. In *Rangatira Ltd v CIR* [1997] 1 NZLR 129 (PC) a company invested on a long-term basis in shares in established well performing companies. Over time, shares were sold and often profits were made on the sales. The Privy Council decided sales were not carried out in the ordinary course of the taxpayer's business. The number and frequency of the transactions (41 sales) during a seven-year period were not, by themselves, sufficient to conclude the company was a share trader.

162. *CIR v Stockwell* (1992) 14 NZTC 9,190 (CA) concerned the deductibility of losses made on share sales. The court agreed with submissions that there is likely a business where a person:

- spends a significant part of each day pursuing share trading activities;
- has some tens of thousands of dollars at risk; and
- engages in around 10 transactions per month.

163. Similarly, the court thought there is likely not a business where a person invested a significant amount (for the time) in the shares of only two or three companies and did not engage in active trading.

164. The taxpayer in *Stockwell* had spent $70,000 on the shares of six companies. Thirteen parcels of shares were purchased, and nine parcels were sold over nine months. This was considered to be a borderline fact situation. The court leaned against finding a business. Cooke P said at 9,194:

> When a taxpayer has a full-time occupation and devotes some of his spare time to stock exchange speculation, one should be slow, I think, to find that he has gone as far as to embark on a business. Usually it would be an artificial use of language. The same applies to a retired or unemployed person who engages in a modest amount of buying and selling shares. In such cases the presumption should be against a business.

165. Hardie Boys J similarly said at 9,194:

> The buying and selling of shares is typical of many activities that may or may not be a business according to the individual circumstances. Carried on merely to supplement an adequate income from other sources or to provide interest or excitement, it is unlikely to be a business. That the person may regard himself as a "trader" is of little assistance. One would **normally expect to find a considerable number of purchases and sales over an appreciable period of time before he could be regarded as dealing in shares and a substantial capital investment before one would take the next step of regarding him as in the business of dealing in shares**. [Emphasis added]

166. In *London Australia Investment Company Ltd v FCT* (1974) 4 ALR 44 (HCA) a company invested in shares for the purpose of earning dividend income and had a specific policy of maintaining a consistent dividend yield. It regularly reviewed the portfolio and sold

shares that were not paying sufficient dividends, and then reinvested the sale proceeds. These sales would often produce a profit.

167. In the High Court of Australia, Gibbs and Jacobs JJ found the income was taxable as it resulted from carrying on a business. This was because:

- during the three years in question, it was considered an integral part of the taxpayer's business to deal in shares;
- switching investments was desirable to produce the best dividend returns and was necessary if the taxpayer's policy of investing in shares with growth potential was to be adhered to;
- the share portfolio was given regular consideration; and
- the taxpayer systematically sold its shares at a profit for the purpose of increasing the dividend yield of its investments.

168. The cases considered above provide guidance for determining whether an investor's share sales could be considered part of a business of share dealing.

169. To summarise, the following factors were relevant to a finding by the courts that there was a business of share dealing:

- share sales were an integral part of the business, and part of the normal operations of the business;
- there was regular or continuous monitoring of the share portfolio, and a system according to which shares were sold;
- sales were frequent, and both sales and purchases are made on a large scale; and
- a large amount of money was invested.

Income from a business of share dealing

170. Section CB 5 also applies to tax income from a share dealing business. This section appears similar to s CB 1 because it taxes sales of personal property (such as shares) when that person's "business" is to deal in property of that kind. However, distinctions exist between the provisions.

171. In *Piers v CIR* (1995) 17 NZTC 12,283 (HC) the trustees of a pension fund held investments that were managed by a financial institution. The institution operated a computer model that prescribed certain ratios of different risk weightings for share investments. As the values of shares changed, so did the required ratios and weightings. This meant shares had to be bought and sold to remain within the limits of the model.

172. Temm J held that the trustees were not in business under s CB 1 because they were merely discharging their statutory and fiduciary obligations as trustees of the fund. There was no profit-making intention underlying the share sales. However, Temm J observed that the frequency of share dealing transactions is often decisive in deciding whether profits are taxable under s CB 5, and that the purpose or motive of the business enterprise is of less relevance than the extent of it. Temm J held that the fund was dealing in shares within the meaning of s CB 5.

173. Essentially, the difference between the provisions is whether the taxpayer has the intention to be in a "business". Without a profit-making intention, the person may not have a business under s CB 1 but may still be considered to be in the business of dealing under s CB 5 if they have a sufficient level of activity.

Profit-making undertaking or scheme

174. Section CB 3 provides that an amount is income if it is derived from carrying on or carrying out an undertaking or scheme entered into or devised for the purpose of making a profit.

175. The undertaking or scheme must be carried on or carried out. The Australian equivalent of s CB 3 was considered in *Premier Automatic Ticket Issuers Ltd v FCT* (1933) 50 CLR 268 (HCA). Dixon J observed that the terms carried on or carried out cover both the habitual pursuit of a course of conduct, as well as the execution of a plan or venture that does not involve repetition or a system. This was cited with approval in New Zealand in *Duff v CIR* (1982) 5 TRNZ 343 (CA).

176. Several cases have considered what is an undertaking or scheme under s CB 3. Essentially:

- a scheme involves a series of steps directed to an end result;
- an undertaking is an enterprise directed to an end result;
- there needs to be a plan or purpose that is coherent and has some unity of conception, but does not need to be precise;
- the assessment of any profit-making purpose is made at the time the scheme is entered into;
- property that is already held can become part of a later formulated scheme;
- the profit-making purpose must be the person's dominant purpose;
- a nexus (or connection) must exist between the undertaking or scheme and any gain derived; and
- the scheme must produce a revenue gain - capital gains are not included.

177. For completeness, if a person acquired shares as part of a share dealing profit making scheme involving sales, it is likely that the person acquired shares for the purpose of disposal and s CB 4 would apply to the sales of those shares in any event. The Commissioner accepts it would be unusual for s CB 3 to apply to investments in widely held shares acquired through a platform or broker.

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In draft form these items may not be relied on by taxation officers, taxpayers, or practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

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