Inland Revenue
Te Tari Taake

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

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FACT SHEET | PUKA MEKA

Income tax – Overdrawn shareholder loan account balances

Issued | Tukuna: Issue Date

IS ##/## FS 1

This fact sheet accompanies **IS ##/##: Income tax – Overdrawn shareholder loan account balances**, which considers tax implications arising from overdrawn shareholder loan accounts.

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

Introduction | Whakataki

1. Small businesses that are owned and operated by family members often trade through close companies. Because a shareholder may exert a high degree of control over a close company, it is often easy for them to draw company funds for private purposes.

2. Shareholder loan accounts are generally informal arrangements between companies and shareholders that keep track of any advances made between them. When a shareholder draws more money from the company than they have advanced to the company, their shareholder loan account becomes overdrawn.

3. This fact sheet explains some of the main rules discussed in **IS ##/##**, including:

   - when the dividend or fringe benefit tax (FBT) rules apply to nil- or low-interest loan accounts;
   - how to calculate the amount of the dividend or fringe benefit;
   - how amounts paid to shareholders can be retrospectively credited to overdrawn shareholder loan accounts;
   - when to withhold RWT from any interest charged;
   - when the investment income reporting rules apply; and
   - what happens if a shareholder is relieved of repaying the overdrawn balance.

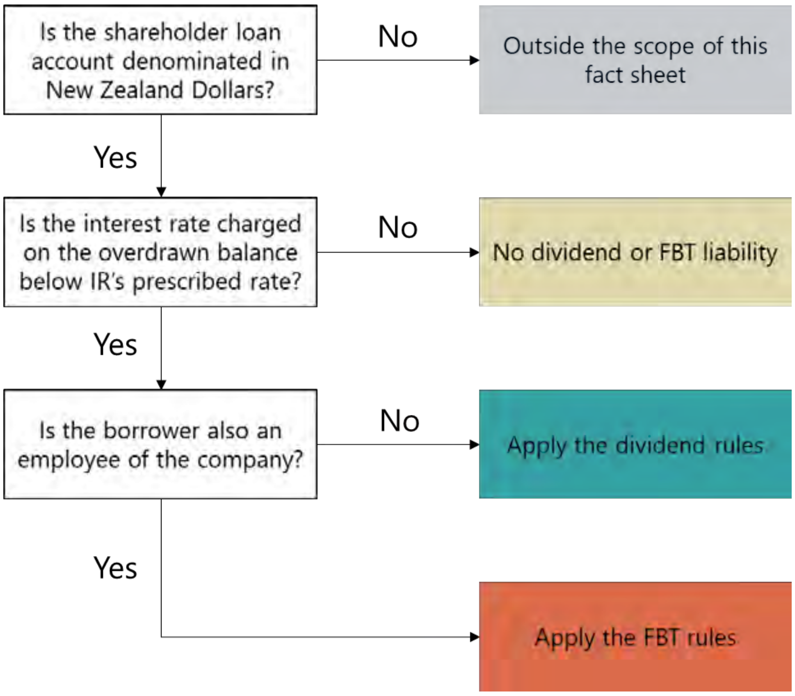
4. As with **IS ##/##**, this fact sheet covers tax issues relating to overdrawn shareholder loan accounts that are:

   - owed to close companies that are resident in New Zealand under New Zealand tax law; and
   - owed by shareholders who are natural persons and resident in New Zealand under New Zealand tax law.

Determining whether the dividend or the FBT rules apply

5. Where a company provides a benefit in the form of an interest-free or low-interest loan to a shareholder, either the dividend or the FBT rules apply to that benefit. Figure | Hoahoa 1 will help to determine which set of rules applies. Essentially, the distinction turns on whether the person receiving the loan is a shareholder or a shareholder-employee.

Figure | Hoahoa 1: Determining which rules apply to the benefit of an interest-free or low-interest overdrawn shareholder loan account



How to calculate the dividend or fringe benefit

6. The amount of the dividend or fringe benefit is generally calculated using the following formula:

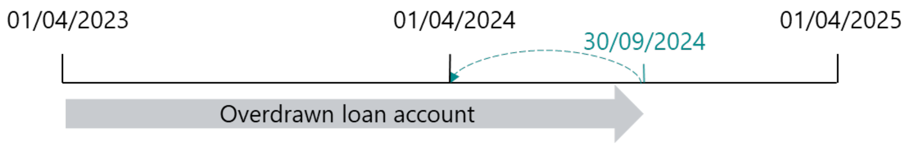
$$\left(\text{Loan balance} \times \text{Prescribed rate} \times \frac{\text{Overdrawn days}}{365}\right) - \text{Actual interest accrued}$$

Loan balance

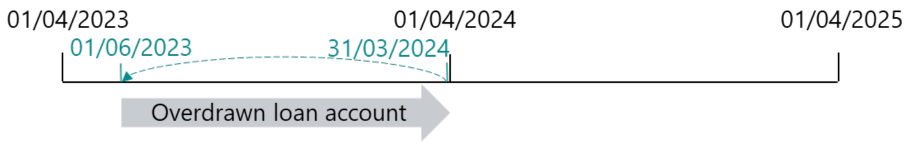
7. The loan balance is determined on a daily basis. It needs to account for any amounts the company pays to the shareholder that can be retrospectively credited to the loan account.

8. For instance, under the dividend rules, amounts a company pays to shareholders can be credited back to the later of:
   - the start of the year in which it pays them; or
   - when the loan account first becomes overdrawn.

9. A fully imputed dividend paid on 30 September 2024 and applied to repay the loan account that became overdrawn in an earlier year can be credited back to 1 April 2024 as follows:



10. Where a company pays a fully imputed dividend on 31 March 2024, the dividend can go back to the later of the previous 1 April or when the loan account became overdrawn, as follows:

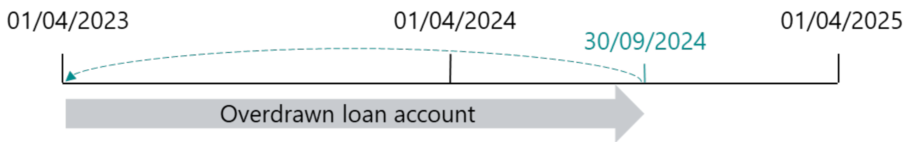


11. Similarly, under the FBT rules, amounts shareholder-employees derive from their respective companies can be credited back to the later of:

- the start of the year in which the amount is derived; or
- when the loan account first becomes overdrawn.

12. However, an amount derived in a later year can also be credited further back to an earlier year, provided the shareholder-employee treats the amount as taxable in that earlier income year.

13. For example, a shareholder salary for the year ending 31 March 2024 but paid on 30 September 2024 may be credited to 1 April 2023 if the shareholder elects to treat the amount as taxable in the 2024 income year, as follows:



Prescribed rate

14. The prescribed rate is the applicable "prescribed rate of interest" for the relevant period, which is available at Prescribed interest rates for fringe benefit tax (FBT) on the Inland Revenue website.

Overdrawn days

15. The overdrawn days are the number of days the shareholder loan account is overdrawn in the relevant period. For dividends, the relevant period will be each quarter in which the loan account is overdrawn (s CD 39(2)). For fringe benefits, the relevant period will also be a quarter unless the company has elected to use the income year option for close companies (s RD 60(2)).

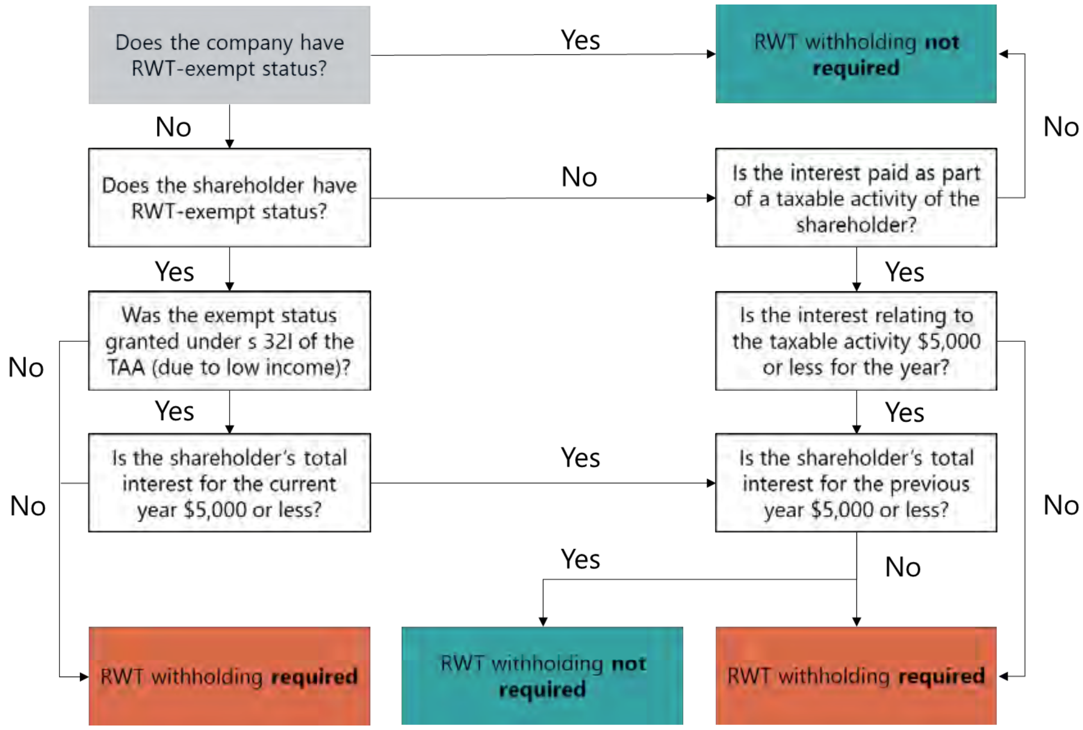
Actual interest accrued

16. The dividend or fringe benefit is reduced by any interest accrued on the overdrawn shareholder loan account for the relevant period. This means if the shareholder is charged interest on the overdrawn loan account at the prescribed rate, no dividend or fringe benefit arises. However, because the shareholder is paying interest, they may need to deduct RWT or provide investment income information to Inland Revenue.

When to withhold RWT from any interest charged

17. In some instances, a shareholder may need to withhold RWT and pay it to Inland Revenue when they pay interest on an overdrawn shareholder loan account balance. Figure | Hoahoa 2 summarises the circumstances in which this requirement applies.

Figure | Hoahoa 2: Is a shareholder required to withhold RWT from interest they have paid?

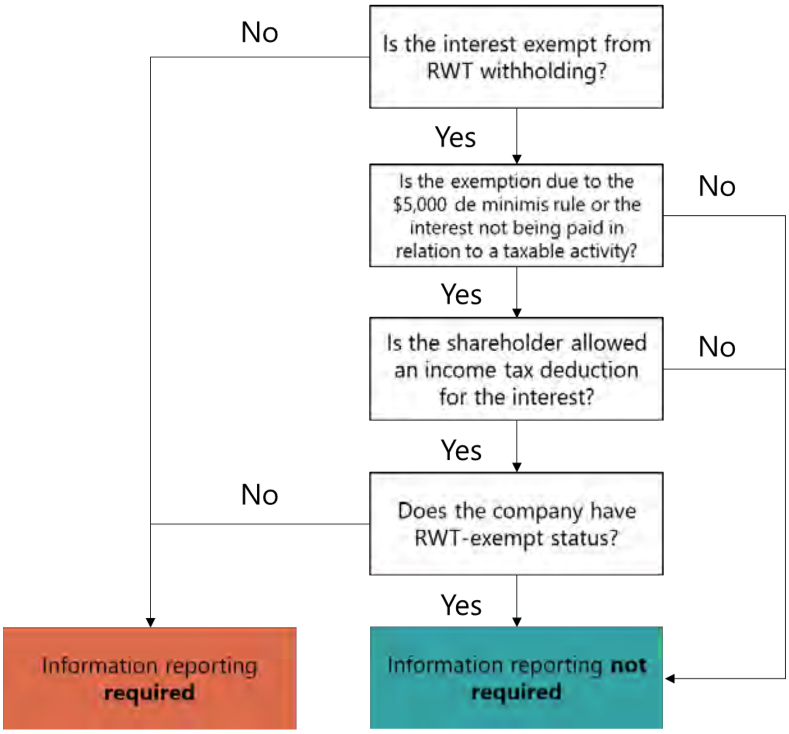


When the investment income reporting rules apply

18. If a shareholder needs to withhold RWT and pay it to Inland Revenue, they will have a corresponding obligation to provide investment income information along with the payment. However, in some instances they need to provide this information despite not needing to deduct RWT.

19. Figure | Hoahoa 3 will help shareholders to determine when they need to provide investment income information.

Figure | Hoahoa 3: Is a shareholder required to report information under the investment income reporting rules?



What happens if a shareholder is relieved of repaying the overdrawn balance

20. Because the affairs of the shareholders and close companies are intimately linked, sometimes the company may agree that the shareholder does not need to repay the balance of their overdrawn loan account. If a shareholder is relieved of their obligation to repay their overdrawn shareholder current account balance, income (to the amount forgiven) will arise under the dividend rules or under the FA rules.

About this document | Mō tēnei tuhinga

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