Inland Revenue
Te Tari Taake

FACT SHEET | PUKA MEKA

Income tax – Overdrawn shareholder loan account balances

Issued | Tukuna: 5 November 2024

IS 24/09 FS 1

This fact sheet accompanies **IS 24/09: Income tax – Overdrawn shareholder loan account balances**, which considers common 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. These drawings are recorded in "shareholder loan accounts", which are also often referred to as a "shareholder current account".

2. Shareholder loan accounts are generally informal arrangements between companies and shareholders that keep track of any advances made between them.

3. An overdrawn shareholder loan account balance arises when a shareholder draws or borrows money from a company and the total amount drawn exceeds the amount of money the shareholder has loaned to the company. Essentially, the company is lending the amount of the overdrawn balance to the shareholder. Often, this occurs throughout the course of a year when a shareholder takes drawings from a company to fund their private expenditure (eg, living costs) in advance of receiving income from the company (eg, salary or dividends). In many cases, the income is calculated and credited to the shareholder loan account after the end of a financial year.

4. There are a number of tax implications when a shareholder loan account becomes overdrawn. In particular:

   - the dividend or the fringe benefit tax (FBT) rules will apply if the company charges **no or low interest** on the overdrawn balance;
   - if the company **does charge interest** on the overdrawn balance, there are also other issues to consider. For example:
     - derivation of interest or financial arrangements income,
     - interest deductibility, and
     - withholding and reporting obligations.

5. This fact sheet explains some of the main rules discussed in **IS 24/09**, including:

   - when the dividend or the 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.

6. As with **IS 24/09**, this fact sheet covers tax issues relating to overdrawn shareholder loan accounts that are:

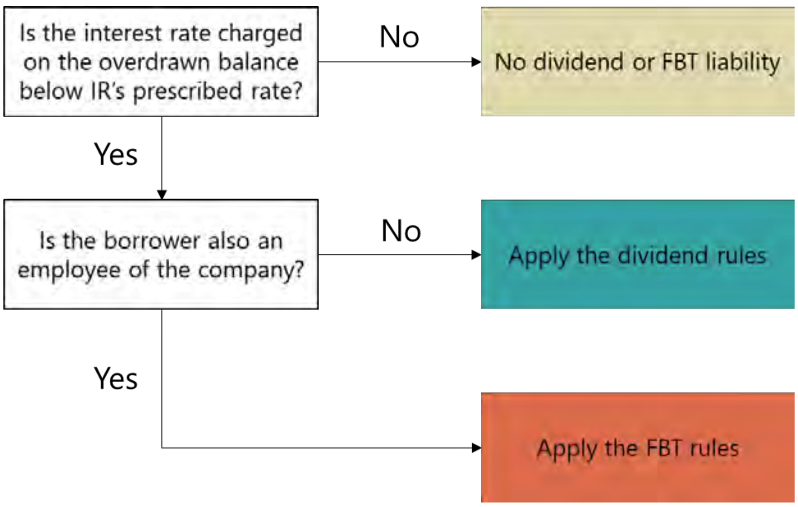
- owed to close companies that are resident in New Zealand under New Zealand tax law; and
- owed by **shareholders who are natural persons** and resident in New Zealand under New Zealand tax law.

Determining whether the dividend or the FBT rules apply

7. 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. Because an overdrawn shareholder loan account is a loan from a company to the relevant shareholder, the same rules will apply if the company charges no or low interest on the overdrawn balance.

8. 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[1]



[1] Figure | Hoahoa 1 applies only to loan accounts denominated in NZ Dollars. Where the loan account is expressed in a single foreign currency, the applicable benchmark interest is calculated using the benchmark rate that the Commissioner has set for that currency, if any. See paragraph [37] of IS [XX/XX] for further information.

How to calculate the dividend or fringe benefit

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

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

10. Each of the components in the formula is explained below.

Loan balance

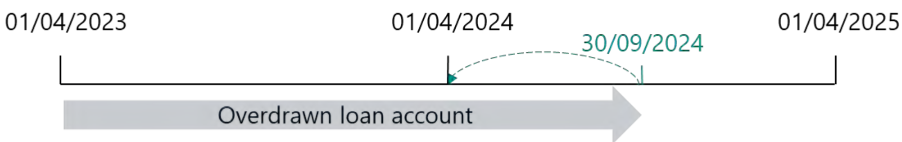
11. The loan balance is determined on a daily basis. It needs to account for any amounts the company pays to the shareholder that can be retrospectively credited to the loan account.

Backdating under the dividend rules

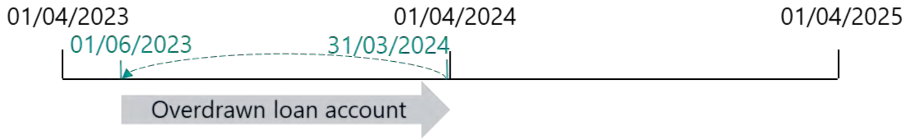
12. For instance, under the dividend rules, certain amounts a company pays to shareholders (such as a fully imputed dividend) can be used to repay an overdrawn loan account and be treated as having been repaid on the later of:

- the start of the year in which the company pays them; or
- when the loan account first becomes overdrawn.

13. For example, 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 (to the extent of the loan repayment) back to 1 April 2024 as follows:



14. Where a company pays a fully imputed dividend on 31 March 2024, the amount of the dividend applied to repay an overdrawn loan account can be treated as having been credited on the later of the previous 1 April or the date when the loan account became overdrawn. This is depicted as follows:



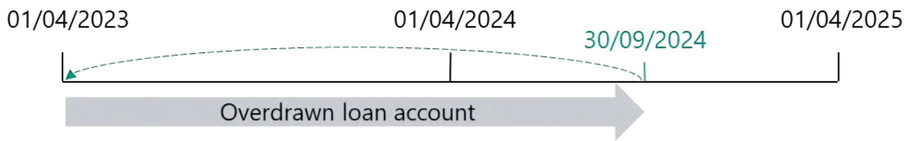
Backdating under the FBT rules

15. Similarly, under the FBT rules, certain amounts shareholder-employees derive from their respective companies can be used to repay the shareholder-employees' overdrawn loan account. The repayment can be dated back to the later of:

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

16. However, under the FBT rules, an amount derived in a later year can also be credited further back to an earlier year. The shareholder-employee needs to also treat the amount as taxable in that earlier income year.

17. Only the amount of the loan repayment can be backdated. 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, to the extent the amount is repaying an overdrawn loan account, if the shareholder elects to treat the amount as taxable in the 2024 income year. This is depicted as follows:



Prescribed rate

18. 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

19. 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)).

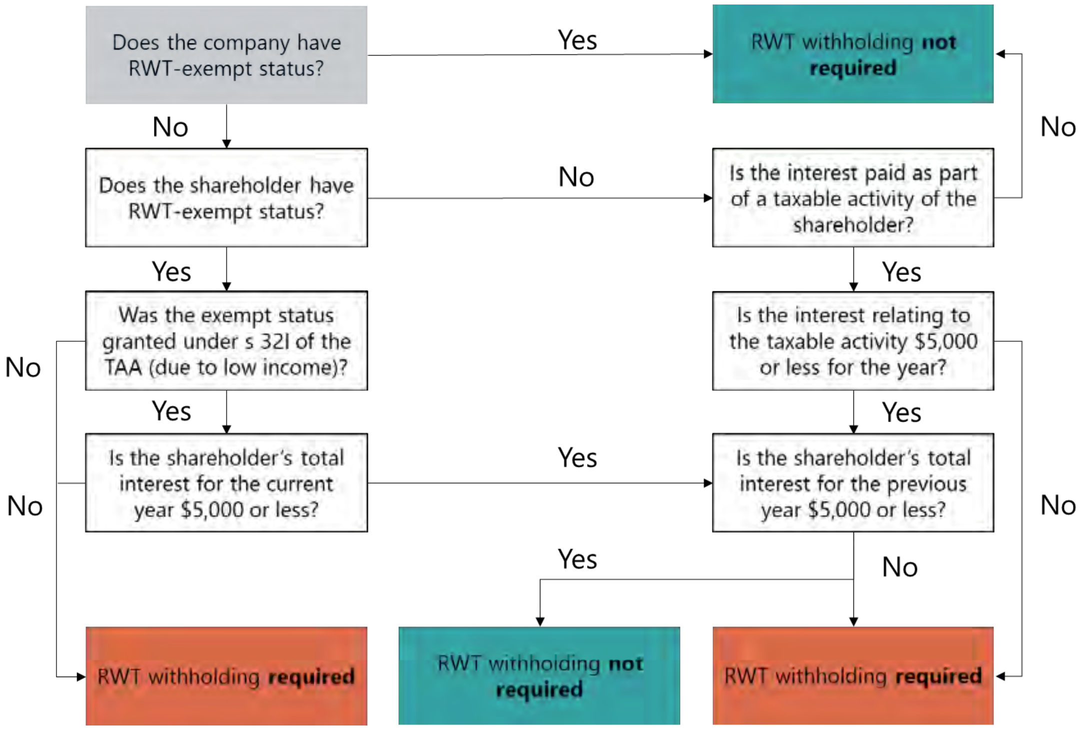
Actual interest accrued

20. 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

21. 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?



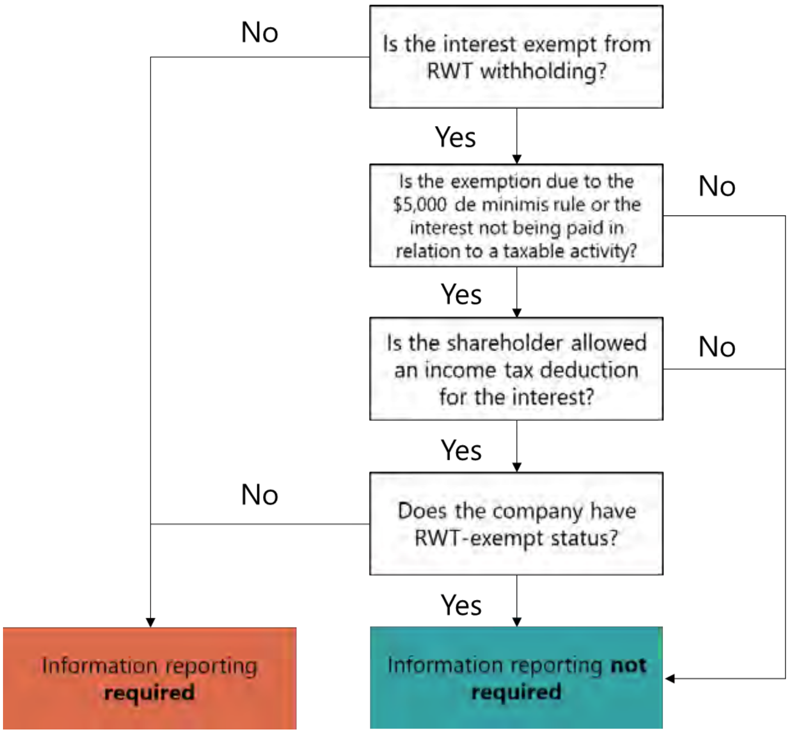
When the investment income reporting rules apply

22. 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.

23. 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

24. 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

Some of the Tax Counsel Office's longer or more complex items are accompanied by a fact sheet that summarises and explains an item's main points. While it summarises the Commissioner's considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further Status of Commissioner's advice (Commissioner's Statement, Inland Revenue, December 2012).