Part 1B - amalgamations

Section 29 of the Income Tax Amendment Act 1994 inserts a new section 191WD into the Act.

Amalgamation - Companies Act

The Companies Act 1955 (CA 1955) and Companies Act 1993 (CA 1993) allow two or more companies to amalgamate and continue as one company which may be a new company or one of the amalgamating companies.

The amalgamated company succeeds to all the property, rights, powers and privileges of each amalgamating company and assumes all of their liabilities and obligations.

All companies can amalgamate from 1 July 1994, regardless of whether they have re-registered, using either the long form procedure or short form procedure (if the amalgamating companies are a wholly-owned group, as discussed below.)

Long form amalgamation

The long form amalgamation procedure is contained in sections 220 and 221 of the CA 1993 and sections 209B and 209C of the CA 1955. It involves preparing an amalgamation proposal which sets out the terms of the amalgamation. The proposal must be approved by the Board of Directors of each amalgamating company, who must also pass resolutions that confirm both of these points:

- that the amalgamation is in the best interests of the company
- that the amalgamated company will satisfy the solvency test immediately after the amalgamation.

In addition, each Board must notify the following parties of the proposed amalgamation not less than 20 working days before the amalgamation:

- the shareholders
- all secured creditors
- public

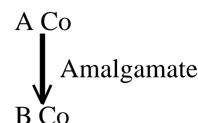
The shareholders of each amalgamating company must also approve the amalgamation by special resolution.

The amalgamation proposal and other necessary documentation must be delivered to the Registrar of Companies for registration.

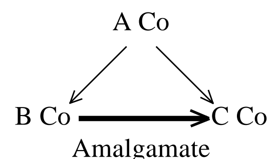
Short form amalgamation

This procedure is available if the amalgamating companies are part of a wholly-owned group and the amalgamation is between companies in either of these situations:

- parent company and one or more subsidiaries:



- two or more subsidiaries owned directly or indirectly by the same parent company:



An amalgamation proposal does not have to be prepared under the short form amalgamation procedure, and the shareholders do not have to approve the amalgamation.

To amalgamate under the short form procedure, the Board of Directors of each amalgamating company must resolve the following points:

- that the shares of each amalgamating company other than the amalgamated company will be cancelled without payment or other consideration
- that the constitution of the amalgamated company (if it has one) will be the same as that of the parent company (in a vertical amalgamation) or the surviving subsidiary (in a horizontal amalgamation)
- that the amalgamated company will pass the solvency test immediately after the amalgamation.

The Board of each amalgamating company must also give notice of the amalgamation to all secured creditors at least 20 working days before the amalgamation.

As with the long form amalgamation procedure, the relevant documentation must be delivered to the Registrar of Companies for registration.

Amalgamation - Income Tax Act

Section 191WD of the Act has been enacted to set out the tax consequences arising on amalgamation. This section provides concessional tax treatment for qualifying amalgamations. In effect it allows most assets of amalgamating companies on a qualifying amalgamation to be acquired by the amalgamated company at their tax book value. It also enables an amalgamated company to take over the tax losses and imputation credits of amalgamating companies if the continuity tests and commonality tests are met.

Definitions - section 191WD(2)

An "**amalgamated company**" is the company which results from and continues after the amalgamation. It may be one of the amalgamating companies or a new company.

An "**amalgamating company**" is a company which amalgamates with one or more companies under an amalgamation.

The term "**amalgamation**" is defined for the purposes of the Act as an amalgamation occurring under the CA 1955, the CA 1993, the Co-operative Dairy Companies Act 1949 or similar foreign legislation.

An amalgamation is a "**qualifying amalgamation**" if each of the amalgamating companies and the amalgamated company are resident in New Zealand and are not exempt from income tax. The definition excludes a company which is resident in New Zealand but deemed to be non-resident under a double tax agreement.

In addition, if the amalgamated company is a qualifying company, each of the amalgamating companies must have also been a qualifying company in order for the amalgamation to be a qualifying amalgamation. A similar requirement is included for loss attributing qualifying companies. This prevents a company from becoming a qualifying company without paying qualifying company election tax.

Most of the concessionary amalgamation provisions apply only to qualifying amalgamations. The amalgamation regime was designed in this way so it could not be used to transfer assets out of the New Zealand tax base without tax implications. Parties to an amalgamation may elect that the amalgamation be a non-qualifying amalgamation, for example, if they wish assets of the amalgamating companies to be transferred to the amalgamated company at market value.

"**Revenue account property**" incorporates trading stock of an amalgamating company and any other property of the company if a gain on disposal would be assessable, other than a depreciation clawback under section 117 of the Act. This includes land of the amalgamating company if a gain on disposal on the date of amalgamation would be assessable under section 67 of the Act.

Notice in writing to Commissioner - section 191WD(3)

The amalgamated company must give notice of the amalgamation to the Commissioner of Inland Revenue within 63 days of whichever of these events applies:

- the documentation required to effect an amalgamation under the CA 1955 or the CA 1993 being delivered to the Registrar of Companies
- the extraordinary resolution required for an amalgamation to occur under the Co-operative Dairy Companies Act 1949 being passed
- an equivalent procedure occurring under foreign law.

A prescribed form for giving notice to the Commissioner is currently being designed. If companies are amalgamating before the form is available, they should send a letter to the Commissioner, notifying him of the amalgamation.

The details provided to the Commissioner should include:

- the name and IRD number of each amalgamating company and of the amalgamated company
- the date of amalgamation
- the balance date of the amalgamated company if it is a non-standard balance date
- such other information as the Commissioner requires.

This will include any other information required by the Commissioner to enable Inland Revenue's FIRST computer system to transfer relevant details from the IRD numbers of the amalgamating companies to that of the amalgamated company.

Non-standard balance date

If an amalgamating company has a non-standard balance date, that balance date may only be used by the amalgamated company if the company which continues to exist as the amalgamated company is the amalgamating company with the non-standard balance date, or the amalgamated company applies to the Commissioner for consent to adopt that balance date.

Example

A Co has a 31 March balance date

B Co has a 30 June balance date

If these companies amalgamate and A Co remains as the amalgamated company or the amalgamated company is a new company, C Co, the amalgamated company will have a 31 March balance date unless the Commissioner consents to an election for a 30 June balance date.

However, if B Co is the amalgamated company it will have a 30 June balance date, unless the amalgamated company seeks the Commissioner's approval to change it.

Adjustments to available subscribed capital on amalgamation

The available subscribed capital of an amalgamated company will generally be the sum of the available subscribed capital of each amalgamating company. However, an adjustment is required in certain circumstances. Adjustment provisions are included in section 191WD and also in the definition of available subscribed capital in section 4A(3).

Cancellation of shares in amalgamated company held by amalgamating company - section 191WD(4)

If an amalgamating company holds shares in an amalgamated company before the amalgamation, these shares will be cancelled on amalgamation. An adjustment is required to the available subscribed capital of the amalgamated company to reflect this cancellation.

The amalgamated company's available subscribed capital is reduced by increasing the amount of item "c" in the definition of available subscribed capital by the amount calculated by the following formula:

a x b

In this formula:

a is the number of shares cancelled

b is the available subscribed capital per share of shares of that class immediately before the amalgamation.

Example

B Co has 1,000 shares on issue, of which A Co holds 200.

A Co and B Co amalgamate on 1 April 1995 and B Co continues as the amalgamated company.

The available subscribed capital per share in B Co at 31 March 1995 is $10.

Under section 191WD(4) the available subscribed capital of B Co after the amalgamation is reduced by adding the following amount to item "c" of the definition of available subscribed capital:

200 x $10 = $2,000

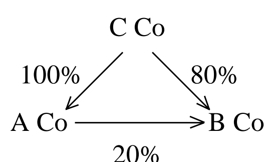
Adjustment to available subscribed capital on short form amalgamation of sister companies - section 4A(3) definition of available subscribed capital item b(iv)

If sister companies within a wholly owned group amalgamate using the short form amalgamation, all shares in the discontinuing amalgamating company are cancelled under company law for no consideration (including the issue of shares as consideration.) As item "b" in the available subscribed capital formula only includes consideration received, the available subscribed capital of the amalgamated company would not reflect that of the amalgamating company.

However, item b(iv) of the definition deems an amount equal to the available subscribed capital of the amalgamating company to be consideration received by the amalgamated company, less any cross shareholdings.

Example

A Co and B Co were each incorporated in November 1994. A Co issued 2000 shares for $1 each. B Co issued 1000 shares for $1 each. C Co holds all of the shares in A Co and 80% of the shares in B Co. A Co holds the other 20% of shares in B Co.



A Co and B Co amalgamate using the short form amalgamation procedure. B Co remains as the amalgamated company. The available subscribed capital of the amalgamated company will be as follows:

a + b + c

a = 0
b = 1000 + 2000 - 200
c = 0

The available subscribed capital of the amalgamated company is therefore $2,800.

Limit to increase of available subscribed capital on a long form amalgamation - share for share swap - section 4A(3) definition of available subscribed capital item b (x)

Item b (x) of the definition of available subscribed capital limits the amount by which an amalgamated company's available subscribed capital is increased when companies amalgamate using the long form amalgamation procedure. Under paragraph (x), consideration provided to the amalgamated company will be excluded from the amalgamated company's available subscribed capital to the extent that it exceeds the available subscribed capital of the amalgamating company.

This will prevent companies from amalgamating to generate available subscribed capital in excess of the aggregate available subscribed capital of the amalgamating companies.

Example

A Co has available subscribed capital of $700 and a market value of $1,200.

B Co has available subscribed capital of $900.

C Co holds all the shares in A Co.

A Co and B Co amalgamate using the long form amalgamation procedure. B Co remains as the amalgamated company. The shares in A Co are cancelled and the assets and liabilities are transferred to B Co.

C Co receives shares in B Co to the value of $1,200.

The available subscribed capital of the amalgamated company is calculated as follows:

a + b - c

a = 0
b = $900 + ($1,200 - $500)
c = 0

The available subscribed capital of the amalgamated company is therefore $1,600.

Cancellation of shares in an amalgamating company held by another amalgamating company - section 191WD(6)

If an amalgamating company holds shares in another amalgamating company, those shares are cancelled on amalgamation. The shares are deemed to have been disposed of immediately before the amalgamation.

If the amalgamating company holds the shares as trading stock at the beginning of the year of amalgamation, the deemed consideration will be (at the taxpayer's option) either the cost, market selling value or replacement cost of the shares at the time of the amalgamation.

If the amalgamating company does not hold the shares as trading stock at the start of the year of amalgamation, the deemed consideration will be the cost of the shares.

Example 1

B Co and C Co have each issued 100 shares at $1 per share. B Co holds 20 of C Co's shares on capital account.

If B Co and C Co amalgamate and C Co remains as the amalgamated company, B Co will be deemed to have disposed of the 20 shares in C Co for $20 consideration.

Section 191WD(6) will also apply when the amalgamated company holds shares in an amalgamating company.

Example 2

B Co and C Co have each issued 100 shares at $1 per share.

B Co acquired 20 shares in C Co for $30. B Co holds these shares on revenue account.

B Co and C Co amalgamate and B Co remains as the amalgamated company.

B Co will be deemed to have disposed of the shares it holds in C Co for $30. As a result, no income or loss will arise to B Co on the deemed disposal.

Shares held by other shareholders

All shares in an amalgamating company which ceases to exist on amalgamation also cease to exist. If such shares are held by another amalgamating company, they are deemed to have been disposed of, as discussed above. Shares held by other shareholders are disposed of for consideration equal to the market value of the shares issued in the amalgamated company and any distributions that the shareholder receives from the company. A shareholder who holds such shares on revenue account will have either assessable income or a loss as a result of the disposal.

Transfer of rights and obligations

Amalgamated company to assume amalgamating company's rights and obligations under IRD Acts - section 191WD(7)

When an amalgamating company ceases to exist on amalgamation, the amalgamated company must comply with the amalgamating company's obligations and liabilities under the Inland Revenue Acts, for the year of amalgamation and all previous income years.

Subsection (7)(b) specifically provides that the amalgamated company must file an income tax return on behalf of the amalgamating company in the year of amalgamation. The amalgamating company's tax return must cover the period up to the date of amalgamation. In addition, the following returns must be lodged with IRD within the period stated in the relevant legislation:

- A reconciliation statement for PAYE and withholding payments (IR 68) to the date of amalgamation, in accordance with section 353(1)(f) of the Act, as the amalgamating company has ceased to be an employer from the date of amalgamation.
- An imputation return from 1 April to the date of amalgamation, under section 394K(2) of the Act.
- A dividend withholding payment account return under section 394ZZC of the Act, if the amalgamating company has elected to maintain a dividend withholding payment account.
- A resident withholding (RWT) deduction reconciliation statement, under section 327I(4) of the Act, if RWT payments have been made during the income year.
- A final GST return to the date of amalgamation, under section 16(2) of the Goods and Services Tax Act 1976, if the amalgamating company is a registered person. If the amalgamated company is not registered for GST before the amalgamation but is likely to make taxable supplies in excess of $30,000 in the twelve months following the amalgamation, it should apply for registration.
- A final FBT return should be lodged for the amalgamating company to the date of amalgamation. This will enable the amalgamating company to apply the de minimis exemptions to the fringe benefits it provides during that period, rather than aggregating the benefits with those provided by other amalgamating companies.
- An employee start-finish reconciliation (IR 66ES), if the amalgamating company was an employer. (It can instead use an IR 66A schedule if the employees will be employed by a different company under the amalgamation.)

From the date of amalgamation, the above information of the amalgamating company will be integrated into

the returns and reconciliation forms of the amalgamated company.

***IR 12 tax deduction forms* -** These should be issued to employees of the amalgamating company to the date of amalgamation, in accordance with section 353(1)(c) and (d) of the Act. When an amalgamation occurs during an income year, the amalgamated company will issue further certificates for the balance of the year.

***FBT Exemption* -** Section 191WD(24) apportions the FBT de minimis exemption for the period in which the amalgamation occurs according to the number of days before or after the amalgamation, as applicable.

If an amalgamating company which ceases to exist pays FBT on a quarterly basis, the $450 exemption will be reduced in the quarter that the amalgamation occurs by an amount calculated as follows:

$$\$450 \times \frac{a}{b}$$

In this formula:

a is the number of days in the quarter after the amalgamation occurs

b is the number of days in the quarter.

Example

Company A and Company B amalgamate on 31 August 1995.

Company B pays FBT on a quarterly basis

Company B has provided benefits to its employees in the quarter commencing I July 1995 to the value of $200.

Company B ceases to exist upon amalgamation

In these circumstances, the $450 exemption is reduced as follows:

$450 x 30/92 = $147

$450 - 147 = $303 exemption

If the amalgamating company pays FBT on an annual basis, the $1800 exemption will be reduced in the same manner.

When an amalgamated company is incorporated upon amalgamation and will be paying FBT on a quarterly basis, the $450 exemption will be reduced in the quarter in which the amalgamation occurs by an amount calculated as follows:

$$\$450 \times \frac{a}{b}$$

In this formula:

a is the number of days in the quarter before the amalgamation occurs

b is the number of days in the quarter.

If the amalgamated company will be paying FBT on an annual basis, the $1800 exemption will be reduced in the same manner.

Example

Company A and Company B amalgamate on 31 August 1995. Both companies cease to exist on amalgamation.

A new company, Company C, is the amalgamated company. Company C will pay FBT on an annual basis

Company C provides fringe benefits to its employees from 1 September 1995 until 31 March 1996 to the value of $800.

In these circumstances, the $1,800 exemption is reduced as follows

$1,800 x 153/365 = $755

$1,800 - 755 = $1,045 exemption

***Paying FBT on annual basis* -** Section 191WD(24)(d) provides that the gross tax deductions and specified superannuation contribution withholding tax deductions payable by an amalgamating company in the year preceding amalgamation are deemed to have been payable by the amalgamated company when calculating whether the amalgamated company meets the requirements under sections 336TA or 336TB of the Act to pay FBT on an annual basis.

***Payment of PAYE on a monthly basis* -** Section 191WD(24)(d) also provides that the gross tax deductions and specified superannuation contribution withholding tax deductions payable by an amalgamating company in the year before amalgamation are deemed to have been payable by the amalgamated company for the purposes of determining whether the amalgamated company is required to pay tax deductions from source deduction payments monthly or twice-monthly.

In addition to the amalgamated company assuming the liabilities of the amalgamating company on amalgamation, it is also entitled to all rights, powers and privileges of the amalgamating company in respect of the year of amalgamation and earlier years. As a result, the objection rights, loss election rights, and rights to refunds of tax and use of money interest are transferred to the amalgamated company.

Amalgamating company's expenditure/losses deductible to amalgamated company on a qualifying amalgamation - section 191WD(8)

An amalgamated company is entitled to a deduction for bad debts written off and for expenditure or loss incurred arising from the activities of an amalgamating company before a qualifying amalgamation, if a deduction is not available to the amalgamated company but would have been available to the amalgamating company if it had continued to exist.

Example

A Co and B Co amalgamate on 31/3/95. A Co remains as the amalgamated company.

At the date of amalgamation, B Co has trade debtors of $10,000. $2,000 of this outstanding amount is written off by A Co on 1/6/95 when the company owing the debt goes into receivership.

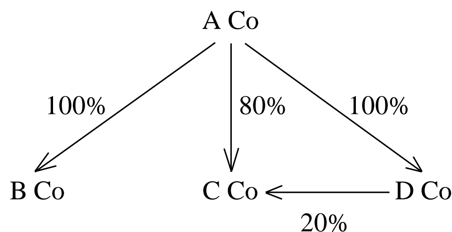
A Co can claim a deduction under section 191WD(8).

Interest deductibility when funds borrowed to purchase shares - section 191WD(9)

Under section 106(1)(h)(ii) a company can claim a deduction for interest payable on money borrowed to buy shares in another company within the same group of companies, provided that the companies are members of the same group at the end of the income year.

If a company has borrowed funds to invest in a company which subsequently amalgamates with another company within the same group, with the result that the requirements of section 106(1)(h)(ii) are not met, subsection (9) provides that the interest will still be deductible if the amalgamation is a qualifying amalgamation.

Example 1



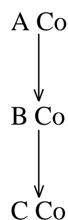
D Co borrowed funds to acquire the 20% shareholding in C Co.

D Co claims a deduction for interest expense under section 106(1)(h)(ii).

B Co and C Co amalgamate, and B Co remains as the amalgamated company.

Section 191WD(9) will enable D Co to continue to claim a deduction for interest expense.

Example 2



B Co borrowed funds to acquire the shares in C Co. B Co claims a deduction for interest expense under section 106(1)(h)(ii).

B Co and C Co amalgamate, and B Co remains as the amalgamated company.

Under section 191WD(9), B Co is able to continue to claim a deduction for interest expense.

Unexpired accrual expenditure of amalgamating company deemed to be expenditure of amalgamated company - section 191WD(10)(a)

Subsection (10)(a) provides that any unexpired portion of accrual expenditure of an amalgamating company, within the meaning of section 104A of the Act, is transferred to the amalgamated company on amalgamation.

As a result, the amalgamating company must include the amount of unexpired accrual expenditure in its assessable income for the purposes of the final tax return prepared for the company to the date of amalgamation. The amalgamated company will be entitled to claim a deduction in respect of the unexpired portion of the accrual expenditure (as at the date of amalgamation) in the year of amalgamation, and must add back any unexpired amounts at year end.

Profit or gain of amalgamating company derived by amalgamated company after amalgamation - section 191WD(10)(b)

If an amalgamated company derives a profit or gain after an amalgamation as a result of the actions of an amalgamating company, subsection 10(b) provides that the profit or gain will be assessable to the amalgamated company if it would have been assessable to the amalgamating company.

Calculating amalgamated company's residual income tax - section 191WD(25)

Subsection (25) allows an amalgamating company's residual income tax (RIT) for the year before amalgamation to be added to the amalgamated company's RIT for the purposes of determining provisional tax issues such as whether the amalgamated company is a provisional taxpayer in the year of amalgamation, the amount of provisional tax payable and whether any additional tax or underestimation penalties apply.

Example

A Co and B Co amalgamate 15/4/95. Their RIT amounts for the year ended 31/3/95 are as follows:

A Co	$10,000
B Co	$12,000
RIT of amalgamated company	$22,000

The amalgamated company's provisional tax liability for the 1996 income year under section 377(1)(a) of the Act is therefore $23,100.

Any provisional tax paid by the amalgamating company in the year of amalgamation should be applied to its own income tax liability for the year to date ending with the date of amalgamation. Any excess may be transferred to the amalgamated company or refunded.

Example

A Co makes the following provisional tax payments for the 1995 income year :

$10,000 7 July 1994
$15,000 7 November 1994

B Co also makes payments, as follows :

$20,000 7 July 1994
$25,000 7 November 1994
$40,000 7 March 1995

A Co and B Co amalgamate on 31/12/94. B Co remains as the amalgamated company.

A tax return is prepared for A Co to 31/12/94.

The assessment issued for that period determines that the total amount of income tax payable by A Co for the 1995 income year is $20,000.

The return indicates that the $5,000 refund due is to be transferred to B Co.

The $5,000 refund plus interest accrued will be credited to B Co as at the date the overpaid tax would have been refunded.

Transfer of property on amalgamation

The assets and liabilities of amalgamating companies are transferred to the amalgamated company on amalgamation. The assets of the amalgamating company are disposed of by the amalgamating company and acquired by the amalgamated company. In general, assets are effectively acquired at tax book value on a qualifying amalgamation and at market value on a non-qualifying amalgamation.

Qualifying amalgamation

Subsection (12) contains general rules for the transfer of assets on a qualifying amalgamation.

Subsections (13) to (17) relate to the transfer of specific types of property. These provisions are similar to the asset transfer rules which apply to consolidated groups (section 191N).

Acquisition of property on a qualifying amalgamation - section 191WD(12)

Under subsection (12), when an amalgamated company acquires property on a qualifying amalgamation, the deemed consideration for the acquisition is the aggregate of the original purchase price and any expenditure incurred by the amalgamating company in purchasing or improving the property or in securing or improving the legal rights of the amalgamating company in respect of the property. This amount will be the deemed consideration provided by the amalgamated company and received by the amalgamating company.

When the property forms the whole of a pool of property that is depreciated in accordance with section 108J of the Act, the deemed consideration is the adjusted tax value of the pool immediately before the amalgamation.

If the property forms part of a pool of property, the deemed consideration is the lesser of the market value of the property acquired and the adjusted tax value of the whole pool immediately before the amalgamation.

When the amalgamating company entered into a binding contract before 16 December 1991 to purchase or construct depreciable property, the amalgamated company is deemed to have entered into the contract on the same date. This prevents the 25% loading from being applied to depreciation rates for the 1991/92 and 1992/93 income years in these circumstances.

Connection with section 67 of the Act

Under subsection (12), an amalgamated company is deemed to have acquired the property on the date that the amalgamating company acquired it. This enables the amalgamated company to calculate the ten year period for the purposes of calculating a profit or gain from land transactions under section 67 of the Act from the original date of acquisition by the amalgamating company rather than from the date of transfer on amalgamation.

Example

A Co and B Co are both investment companies which are in the business of buying and selling commercial properties. They amalgamate on 1/10/95, and the amalgamation is a qualifying amalgamation. A Co remains as the amalgamated company

At the date of amalgamation, B Co held three holiday cottages which were purchased to enable stressed employees and their families to escape the pressures of business and spend some time at the beach or in the mountains. Details of these properties are as follows:

Block 1 purchased 1/3/83, cost - $54,000
Block 2 purchased 1/5/89, cost - $86,000
Block 3 purchased 1/10/94, cost - $200,000

Each block will be transferred at cost to A Co on amalgamation.

A Co sells all three blocks of land on 31/3/96 for the following amounts:

Block 1 - $80,000
Block 2 - $130,000
Block 3 - $210,000

A Co will be assessable on the following amounts :

Block 2 -	proceeds	$130,000
	cost	$86,000
	Profit on sale	$44,000
Block 3 -	proceeds	$210,000
	cost	$200,000
	Profit on sale	$10,000

Acquisition of trading stock on a qualifying amalgamation - section 191WD(13)

When the property acquired on a qualifying amalgamation is trading stock for both the amalgamating company and the amalgamated company, the amalgamating company is deemed to have disposed of the trading stock and the amalgamated company is deemed to have purchased it, at the option of the amalgamated company, at cost price, market selling value, or replacement value at the time of amalgamation. Trading stock is defined in section 85(1) of the Act.

Acquisition of property on a qualifying amalgamation - revenue account property for amalgamating company, but not for amalgamated company - section 191WD(14)

When the property transferred is trading stock of the amalgamating company, or when any profit or gain on disposal will be assessable to the amalgamating company, and the amalgamated company will hold the property on capital account, the amalgamating company is deemed to have disposed of the property and the amalgamated company is deemed to have acquired the property at the market value of the property at the date of the qualifying amalgamation.

Connection with section 67 of the Act

Subsection (14) will apply in circumstances where land transferred is "revenue account property" of the amalgamating company but will be held on capital account by the amalgamated company.

Land will be "revenue account property" if a profit or gain on disposal would be assessable to the amalgamating company at the date of amalgamation under section 67 of the Act. An example of this is when land is purchased for the purpose or intention of resale, for the purposes of the businesses caught by section 67 or in certain circumstances when it was acquired by the amalgamating company or developed less than ten years before the date of amalgamation.

If the amalgamated company is not in that same business (so a profit or gain on disposal within 10 years of the original purchase date would not be assessable to the amalgamated company under section 67 of the Act), the deemed consideration for the transfer on amalgamation will be the market value at the date of amalgamation. This will crystallise unrealised gains and losses from the property at the date of amalgamation.

Example

A Co is a building company. The major shareholder, John, wishes to retire from building but still wants to work part-time. He mentions this to his nephew Joe who runs a building supplies business. Joe knows that John has not been keeping good health lately and doesn't think that John will cope with selling his business.

Joe suggests that the companies amalgamate and that John should come and work part-time in his building supplies centre. He explains that he doesn't wish to get involved in construction but that it will be an easy way for John to wind up his business and he will be a shareholder in B Co.

John agrees but mentions that the company owns the house that his son Jack and his wife live in. He tells Joe that A Co bought the land in June 1989 and had completed construction of the house in July 1990 so that his son had somewhere to live when he returned to New Zealand. Joe tells John that he is happy for Jack to continue renting the property. The amalgamation occurs in December 1994.

The property is "revenue account property" of A Co as, at the date of amalgamation, any profit on disposal would be assessable under section 67(4)(c)(ii). However, the property will be held on capital account by B Co because B Co is not in the business of erecting buildings and did not purchase the property with the intention of resale, so any gain on disposal will not be caught by section 67. The property will therefore be transferred on amalgamation at market value.

Acquisition of depreciating property on a qualifying amalgamation - section 191WD(15)

Subsection (15) relates to circumstances in which an amalgamated company acquires depreciating property, other than pooled property, on a qualifying amalgamation. It provides that for the purposes of sections 108, 117, 137, 142 and any other amortisation provisions of the Act, the amalgamated company is deemed to have been allowed the deductions for depreciation or amortisation that the amalgamating company has been allowed in prior years. As a result, the amalgamated company will be liable for income tax on any subsequent recovery of depreciation on disposal of the asset.

The amalgamated company is deemed to have purchased the asset at the same cost and on the original date that the asset was purchased by the amalgamating company (section 191WD(12)). There is therefore no depreciation claw back on the deemed disposal by the amalgamating company.

The term "depreciating property" is used in section 191N(1) of the Act and refers to property for which the transferor has previously claimed a depreciation deduction under section 108 of the Act or for amortisation of expenditure under section 137 or section 142 of the Act or similar provisions, or will claim a deduction in the year of disposition.

Qualifying amalgamation - Acquisition of business or land used for farming, agriculture, forestry or aquaculture - section 191WD(16)

Subsection (16) deals with amalgamating companies which own land and/or carry on a farming or agricultural business, a forestry business or a business of

aquaculture. It applies if such a company would be entitled to deduct expenditure incurred in relation to that land or business in the year of amalgamation under any of sections 128A to 128C, if the amalgamation had not occurred.

Sections 128A to 128C allow a progressive deduction for certain expenses, included in the Thirteenth Schedule, incurred on land improvements used for farming or forestry or on improvements in relation to aquaculture. The deduction in each income year is an amount equal to a specified percentage of the "diminished value" of the expenditure; that is, the total expenditure less any amount already allowed as a deduction against income.

If the amalgamated company holds the land or carries on the business for the remainder of the year, it will be entitled to the deduction in the year of amalgamation for the expenditure which the amalgamating company would have been entitled to, provided that the amalgamation is a qualifying amalgamation.

Acquisition of a financial arrangement on a qualifying amalgamation - section 191WD(17)

Section 64F of the Act generally requires a base price adjustment calculation to be carried out when a financial arrangement is transferred, in order to allocate income and expenditure in the year of transfer between the transferor and the transferee. Subsection (17) provides three different valuation methods for the transfer of a financial arrangement upon a qualifying amalgamation when the amalgamating company is the holder. A base price adjustment calculation is not required when the first method of calculation can be used.

(a) No base price adjustment calculation is required upon the transfer of a financial arrangement from an amalgamating company to an amalgamated company if all of these conditions are met:

- The amalgamated company uses the same method of calculating income and expenditure under the financial arrangement as the amalgamating company used (for example, if both use the yield to maturity method).
- The amalgamated company elects to include the deemed income accrued or expenditure incurred by the amalgamating company in the year of amalgamation in its tax return for that year.
- The amalgamating company does not include any deemed income accrued or expenditure incurred by the company in the year of amalgamation in its income tax return to the date of amalgamation.
- The amalgamating and amalgamated companies were members of a wholly-owned group at all times in the income year of amalgamation.
- The amalgamating company is not entitled under section 188 of the Act to carry forward and offset any losses from prior years, unless the whole of the loss can be offset against the assessable income of the amalgamated company for the income year, under subsection (19).

If these conditions are met in the year of amalgamation and subsequent years, the amalgamating company is treated as if it had never held the financial arrangement before the amalgamation, while the amalgamated company is treated as if it had acquired the financial arrangement on the same date and for the same acquisition price as the amalgamating company. In addition, the amalgamated company is deemed to have incurred all other expenditure and derived all gains that the amalgamating company has incurred or derived before the amalgamation and to have included these amounts of income and expenditure in its income tax returns.

(b) If the above conditions are not met but there is no change in calculation methods, a deemed consideration figure should be used which results in a fair and reasonable allocation between the amalgamating and amalgamated companies of the income or expenditure for the year of amalgamation.

(c) If there is a change in calculation methods, the transfer is deemed to be made at market value.

Example

A Co and B Co amalgamate on 1/12/95. A Co is a holder of a financial arrangement at the date of amalgamation

The base price adjustment calculation required under section 191WD (17) is as follows :

Debenture stock details

Face value	$500,000
Coupon rate (payable quarterly)	10%
Issue date	1/3/93
Maturity date	1/3/98
Purchase date	1/9/94
Next coupon payment date	1/12/94
Purchase cost	$478,000
Purchase yield to maturity	11.546%
Market yield at the date of amalgamation	9.5%
Assessable income to 31/3/95	$32,156

Base price adjustment at date of amalgamation

	Same method (b) $	Different method (c) $
Item "a" for BPA using purchase constant annual rate of 11.546% *	484,873	
Item "a" for BPA using market value based on a market yield of 9.5% **		505,011

	Same method (b) $	Different method (c) $
"a" = value at date of amalgamation	484,873	505,011
cash coupons (5 x $12,500)	62,500	62,500
	547,373	567,511
"b" = acquisition price	(478,000)	(478,000)
"c" = assessable income to 31/3/95	(32,156)	(32,156)
Base price adjustment	37,217	57,355
Total accrual income 1/9/94 to 1/12/95:		
Accrual income	69,373	89,511

Amalgamated company income from 1/12/95 to 1/3/98

	Same method (b) $	Different method (c) $
"a" = amount of all consideration	500,000	500,000
cash coupons (9 x $12,500)	112,500	112,500
	612,500	612,500
"b" = acquisition price	(484,873)	(505,011)
Accrual income allocated using appropriate method	127,627	107,489

* the constant annual rate having regard to the cash flows.

** the market yield having regard to market valuation.

Succession to obligations under a financial arrangement on a qualifying amalgamation - section 191WD(18)

Subsection (18) in essence mirrors the treatment in subsection (17) of financial arrangements when the amalgamating company is the issuer.

Inter-amalgamating company financial arrangements

The Government is currently considering the income tax treatment of inter-amalgamating company financial arrangements which exist at the date of amalgamation.

Qualifying amalgamation - no dividend on property transfer - section 191WD(5)(a)

A deemed dividend may arise when property is transferred on amalgamation. For example, if an amalgamated company (which is a shareholder or associated person of a shareholder of the amalgamating company) acquires property from an amalgamating company, a deemed dividend will arise to the extent that the market value of the assets exceeds the consideration provided by the amalgamated company. Subsection (5)(a) provides that a dividend will not arise on the transfer of property if the amalgamation is a qualifying amalgamation.

No dividend on release from obligations owed to amalgamating company - section 191WD(5)(a)

Similarly, where an amalgamated company is relieved of an obligation owed to an amalgamating company at the time of amalgamation, a deemed dividend will not arise if the amalgamation is a qualifying amalgamation.

Transfer capital gain amounts to amalgamated company on qualifying amalgamation - section 191WD(5)(b)

Subsection (5)(b) deals with the transfer of capital gain amounts of the amalgamating company. These may either be distributed to shareholders of the amalgamating company in the course of the amalgamation, or they may be transferred to the amalgamated company upon amalgamation.

Non-qualifying amalgamation

Transfer of property on a non-qualifying amalgamation - section 191WD(11)

If an amalgamated company acquires property from an amalgamating company on a non-qualifying amalgamation, the amalgamating company is deemed to have disposed of the property and the amalgamated company is deemed to have acquired the property for its market value at the date of amalgamation.

The effect of subsection (11) is to equate, for tax purposes, the consequences of a non-qualifying amalgamation with those which would arise from a disposal of assets and liabilities at market value. Hence the tax consequences of a sale at market value occur while the legal consequences pursuant to the amalgamation provisions within the Companies Act flow.

Succession to obligations under a financial arrangement on non-qualifying amalgamation - section 191WD(11)

Subsection (11) also provides that when an amalgamating company is an issuer of a financial arrangement at the time of a non-qualifying amalgamation, the amalgamating company is deemed to have relieved itself of the obligations under the financial arrangement immediately before the amalgamation and the amalgamated company is deemed to have assumed the obligations immediately after the amalgamation. The deemed consideration in each instance is the market price for assuming such obligations on the date of amalgamation.

Losses and CFC tax credits

Subsections (19) to (23) govern whether losses incurred before amalgamation by the amalgamated company, an amalgamating company or another company within the group can be utilised after a qualifying amalgamation. The intention of the provisions is to closely align them with existing rules governing the carry forward and

grouping of tax losses so that the amalgamation regime can not be used to enable companies to carry forward or offset losses which would otherwise be lost.

The provisions apply to income tax losses, attributed foreign losses, foreign investment fund losses and to the crediting of controlled foreign company tax credits which arose before amalgamation.

There are no specific provisions relating to non-qualifying amalgamations. Losses of an amalgamating company are not able to be utilised by an amalgamated company after a non-qualifying amalgamation, unless that amalgamating company becomes the amalgamated company and the general loss carry forward and offset tests are met.

Amalgamating company's pre-amalgamation losses or CFC tax credits - section 191WD(19)

When an amalgamating company has incurred a loss or has a CFC tax credit, and the loss or tax credit has not been offset before amalgamation, subsection (19) sets out the circumstances in which the loss or tax credit may be "inherited" by the amalgamated company.

Two tests must be met:

1. There must be at least 49% shareholder continuity in the amalgamating company ("loss" company) from the beginning of the year in which the loss was incurred or tax credit arose until the date of amalgamation.
2. From the beginning of the year in which the loss was incurred or CFC tax credit arose until the date of amalgamation, the following companies must be at least 66% commonly owned:
   - the amalgamating company which has incurred the loss or has the tax credit
   - the amalgamated company, unless the amalgamated company was only incorporated on amalgamation
   - any company which has amalgamated with the amalgamated company from the date the loss was incurred.

If the commonality and continuity of ownership tests are met, the loss is treated as if it was incurred by, or the tax credit is treated as if it arose to, the amalgamated company.

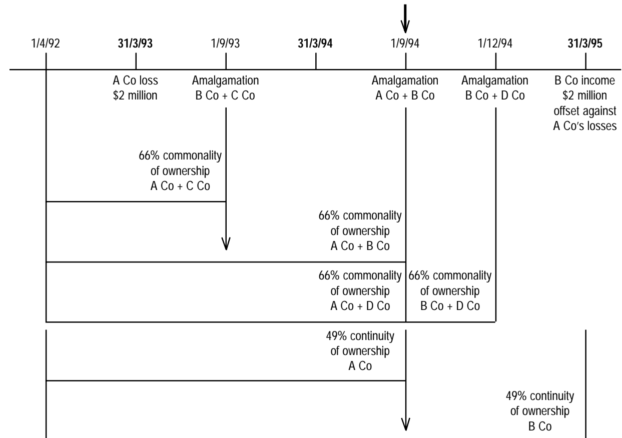
For the amalgamated company to offset the loss against its income, the 49% continuity of ownership test must be met from the date that the loss was incurred or the tax credit arose until the date of offset. For the purposes of the continuity of ownership rules after the amalgamation, the provisions are applied from the beginning of the income year in which the loss was incurred or CFC tax credit arose until the date of amalgamation as if the amalgamated company did not separately exist but was instead the amalgamating companies with the shareholdings that existed during that period.

Example 1

A Co and B Co amalgamate on 1/9/94, C Co amalgamated with B Co 1/9/93, and D Co amalgamates with B Co 1/12/94. B Co remains as the amalgamated company throughout each amalgamation.

A Co incurred a loss in the year ended 31/3/93.

B Co derives assessable income in the year ended 31/3/95.



The income derived by B Co can be offset against the losses incurred by A Co if each of these commonality of ownership and continuity of ownership tests are met.

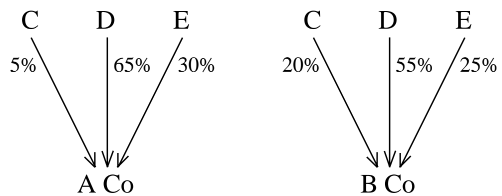
Example 2

A Co and B Co amalgamate on 1 April 1995, and B Co remains as the amalgamated company. A Co has losses carried forward from the 1994 income year.

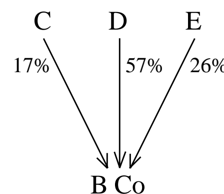
The shareholdings of each company have remained unchanged since incorporation.

The market value of the companies at 31 March 1995 is as follows :

A Co	$200
B Co	$800



After the amalgamation, the shareholders hold shares in the amalgamated company in proportion to the market value of their shareholdings in A Co and B Co.



B Co has assessable income in the 1996 income year. The shareholding of B Co has not changed since amalgamation.

The losses in A Co can be carried forward and utilised by B Co if the continuity and commonality of shareholding tests are met.

Continuity of shareholding - 49%

Shareholder	A Co (1/4/93)	B Co (31/3/96)	Continuity of voting interest
C	5%	17%	5%
D	65%	57%	57%
E	30%	26%	26%
			88%

Commonality of shareholding - 66%

Shareholder	A Co	B Co	Common voting interest
C	5%	20%	5%
D	65%	55%	55%
E	30%	25%	25%
			85%

The 66% commonality test is met at the date of amalgamation. In addition, the 49% continuity of shareholding is maintained by A Co before the amalgamation and by B Co after the amalgamation. The losses "inherited" from A Co can therefore be used to offset the assessable income of B Co in the 1996 income year.

Losses or CFC tax credits attributed to amalgamated company offset against income of group company - section 191WD(22)

Subsection (22) deals with the situation where an amalgamated company has inherited losses or CFC tax credits from an amalgamating company under subsection (19), and wishes to offset the loss or CFC tax credit against the income of another company.

For subsection (22) to apply, 66% commonality must have been maintained by the amalgamating and amalgamated companies, as required in subsection (19). In addition, under subsection (22), 66% commonality of ownership must be established between the amalgamating company with the losses and the group company wishing to utilise the losses. For the period from the date the loss was incurred or CFC tax credit arose until the date of amalgamation, the commonality of ownership test should be applied to the shareholding of the amalgamating company. From the date of amalgamation the test will be applied to the shareholding of the amalgamated company.

Example 1

A Co incurs a loss in the year ended 31/3/93. It then amalgamates with B Co, and B Co remains as the amalgamated company.

C Co has assessable income in the year ended 31/3/95.

1/4/92 | **31/3/93** | **31/3/94** | 1/9/94 | **31/3/95**

A Co loss
$2 million

Amalgamation
A Co + B Co

C Co income
$2 million offset against A Co's pre-amalgamation losses

66% commonality of ownership
A Co + B Co
A Co + C Co

66% commonality of ownership
B Co + C Co

49% continuity of ownership
A Co

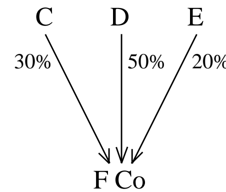
49% continuity of ownership
B Co

Example 2

Following on from Example 2 under section 191WD(19):

B Co wishes to offset the losses against income derived by F Co in the year ended 31 March 1996.

The shareholding of F Co has not changed since its incorporation on 1 April 1991.



In order to fall under subsection (22), the requirements of subsection (19) must be met. In this example, the requirements are met, as calculated in Example 2 under section 191WD(19).

Commonality of shareholding - 66% (before amalgamation)

Shareholder	A Co	F Co	Common voting interest
C	5%	30%	5%
D	65%	50%	50%
E	30%	20%	20%
			75%

As A Co and F Co meet the 66% commonality test from the date the loss was incurred until the date of amalgamation, the test must next be applied to the shareholding of B Co (after the amalgamation) to determine whether the losses of A Co (deemed to be losses of B Co after the amalgamation) may be offset against the income of F Co.

Commonality of shareholding - 66% (after amalgamation)

Shareholder	B Co	F Co	Common voting interest
C	17%	30%	17%
D	57%	50%	50%
E	26%	20%	20%
			87%

As the commonality of shareholding test is met before and after amalgamation, the losses of F Co may be offset by the losses in B Co.

Ordering of tax losses or CFC tax credits of amalgamating companies - section 191WD(20)

When losses incurred by, or CFC tax credits of, two or more amalgamating companies are allowed under subsection (19) to be offset against the income of the amalgamated company, they must be utilised in the order in which they arose. If the losses or CFC tax credits arose in the same income year, the amalgamated company may elect the order in which they will be deducted or credited. The amalgamated company should make this election when it lodges its income tax return. If it does not make an election, a pro rata basis will be used.

Example

A Co amalgamates with B Co, C Co and D Co on 1/12/94. A Co remains as the amalgamated company. It has assessable income of $30,000 in the 1995 income year.

Each of the amalgamating companies has incurred losses in prior years, as follows :

- B Co - $10,000 1991 income year
- C Co - $30,000 1992 income year
- D Co - $20,000 1992 income year

The prior year losses of the amalgamating companies will be utilised in the following manner :

Assessable income	$ 30,000
Losses from 1991 (B Co)	$(10,000)
Losses from 1992 (C Co)	$(12,000)
Losses from 1992 (D Co)	$ (8,000)
	0

Losses carried forward in A Co to 1996 :

- C Co - $18,000 1992 income year
- D Co - $12,000 1992 income year

Alternatively, A Co may elect to utilise all of the losses of D Co or $20,000 of the losses of C Co as these losses arose in the same income year. If A Co elects to utilise the losses of D Co first, the outcome will be as follows :

Assessable income	$30,000
Losses from 1991 (B Co)	$(10,000)
Losses from 1992 (D Co)	$(20,000)
	0

Losses carried forward in A Co to 1996:

- C Co - $30,000 (from 1992 income year)

Pre-amalgamation losses or credits of an amalgamated company - section 191WD(21)

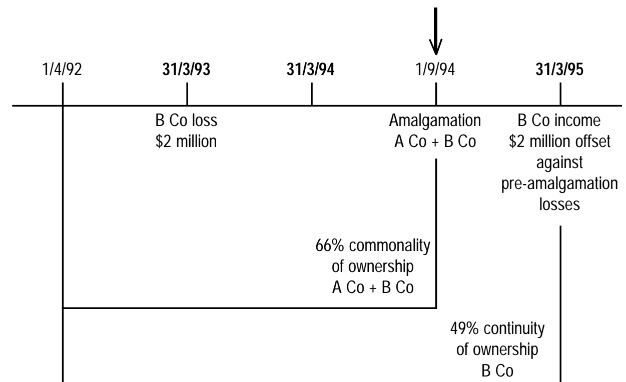
Subsection (21) relates to pre-amalgamation losses of an amalgamating company which remains as the amalgamated company. When an amalgamated company has incurred a loss, or has a CFC tax credit, which arose before amalgamation and which has not been deducted or credited at the date of amalgamation, the following two requirements must be met before the loss or tax credit may be utilised after amalgamation:

1. There must be at least 49% shareholder continuity in the amalgamated company from the beginning of the year in which the loss was incurred or tax credit arose until the date of offset.
2. From the beginning of the year in which the loss was incurred or CFC tax credit arose until the date of amalgamation, the amalgamated company and each of the amalgamating companies must be at least 66% commonly owned.

Example 1

A Co and B Co amalgamate on 1/9/94. B Co remains as the amalgamated company.

B Co incurred a loss in the year ended 31/3/93, and derived assessable income in the year ended 31/3/95.



The income derived by B Co after the amalgamation can be offset against the losses it incurred before amalgamation if these commonality of ownership and continuity of ownership tests are met.

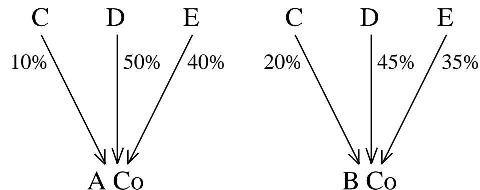
Example 2

A Co and B Co amalgamate on 1 April 1995. B Co remains as the amalgamated company. B Co has losses carried forward from the 1994 income year.

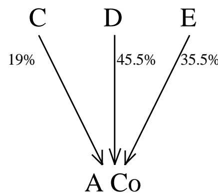
The shareholdings of each company have remained unchanged since incorporation.

The market value of the companies at 31 March 1995 is as follows:

- A Co $100
- B Co $900



After the amalgamation, the shareholders hold shares in the amalgamated company in proportion to the market value of their shareholdings in A Co and B Co.



The losses in B Co can be carried forward and utilised after the amalgamation if the continuity and commonality of shareholding tests are met. For the purposes of the example, B Co has assessable income in the 1996 income year.

Continuity of shareholding - 49%

Shareholder	B Co (1/4/93)	B Co (31/3/96)	Continuity of voting interest
C	20%	19%	19%
D	45%	45.5%	45%
E	35%	35.5%	35%
			99%

Commonality of shareholding - 66%

Shareholder	A Co	B Co	Common voting interest
C	10%	20%	10%
D	50%	45%	45%
E	40%	35%	35%
			90%

The continuity and commonality tests are both met at the date of amalgamation. In addition, 49% continuity of shareholding is maintained until the year of offset. The losses in B Co may therefore be carried forward by B Co and offset against the income in the 1996 income year.

Pre-amalgamation losses or CFC tax credits of group company offset against income of amalgamated company - section 191WD(23)

Subsection (23) relates to the situation where an amalgamated company wishes to offset its income against the losses or tax credit of a group company which is not party to the amalgamation, when the loss or tax credit arose before the amalgamation. The group company may only offset its loss or tax credit against the amalgamated company's income if the commonality of ownership test is met from the date the loss was incurred or the credit arose until the date of offset, that is:

1. From the beginning of the year in which the loss was incurred or CFC tax credit arose until the date of amalgamation, the "loss" company and each of the amalgamating companies must be at least 66% commonly owned.
2. From the date of amalgamation until the date of offset, the "loss" company and the amalgamated company are at least 66% commonly owned.

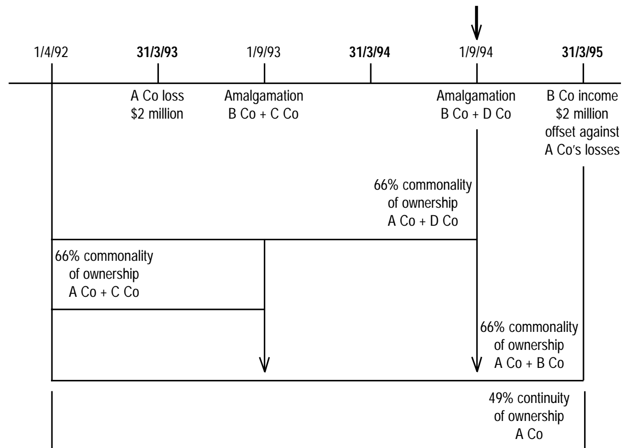
In addition, the "loss" company must have 49% continuity of shareholding from the date the loss was incurred or the tax credit arose until the date of offset.

Example

A Co incurs a loss for the year ended 31/3/93.

B Co and C Co amalgamate on 1/9/93, and B Co amalgamates with D Co 1/9/94. B Co remains as the amalgamated company after each amalgamation.

B Co derives assessable income in the year ended 31/3/95.



The income derived by B Co can be offset against the losses incurred by A Co if these commonality of ownership and continuity of ownership tests are met.

Example 2

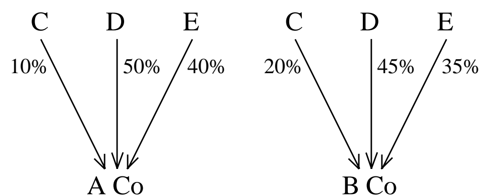
A Co and B Co amalgamate on 1 April 1995. B Co remains as the amalgamated company.

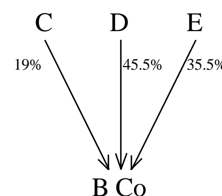
The shareholdings of each company have remained unchanged since incorporation.

The market value of the companies at 31 March 1995 is as follows:

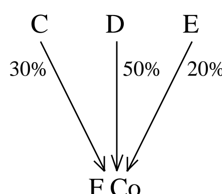
A Co	$100
B Co	$900

After the amalgamation, the shareholders hold shares in the amalgamated company in proportion to the market value of their shareholdings in A Co and B Co.





F Co has losses from the 1994 income year which the companies wish to utilise to offset the income of B Co (the amalgamated company) in the 1996 income year. The shareholding of F Co at 31/3/96 is as follows, and has remained unchanged since incorporation.



The losses can be offset if F Co has maintained 49% continuity and the 66% commonality test is met, as follows:

Commonality of shareholding - 66%
(before amalgamation - 1/4/93 to 1/4/95)

Shareholder	A Co	F Co	Common voting interest
C	10%	30%	10%
D	50%	50%	50%
E	40%	20%	20%
			80%

Commonality of shareholding - 66%
(before amalgamation - 1/4/93 to 1/4/95)

Shareholder	B Co	F Co	Common voting interest
C	20%	30%	20%
D	45%	50%	45%
E	35%	20%	20%
			85%

Commonality of shareholding - 66%
(after amalgamation - 1/4/95 to 31/3/96)

Shareholder	B Co	F Co	Common voting interest
C	19%	30%	19%
D	45.5%	45%	45%
E	35.5%	20%	20%
			84%

The 66% commonality of shareholding is met at the date of offset in respect of both before and after the amalgamation. The losses of F Co can therefore be used to offset the income of B Co in the 1996 income year.

Notional single person

Currently under section 8E(6) of the Act, if any shareholder (except a shareholder who is a company associated with the company whose shares they hold) has less than 10% of the aggregate direct voting interest or direct market value interest in the company, that shareholding and any other shareholdings of less than 10% are deemed to be held by one notional single person who holds all such direct voting interests or direct market value interests in the company. The notional single person is deemed not to hold any other direct voting interest or direct market value interests in any other company.

If the shareholders of two or more amalgamating companies each include a notional single person shareholder, the loss and imputation credit continuity rules in subsections (19) and (26) are applied as if the notional single person in each amalgamating company is the one notional single person. This has the effect of treating the notional single person in the amalgamating company and the notional single person in the amalgamated company as the same person from the date of amalgamation when calculating the continuity of shareholding.

Note that the treatment of all notional single persons in the amalgamating and amalgamated companies as the same person from the date of amalgamation is only for the purposes of determining whether the continuity provisions have been met. The notional single persons in the amalgamating and amalgamated companies are treated as separate persons when calculating the commonality percentages. This is because section 8E(6)(d) of the Act states that the notional single person of a company may not hold a voting interest or market value interest in any other company.

Example

A Co and B Co amalgamate on 1/4/96, with B Co remaining as the amalgamated company.

Each company has a number of shareholders who each hold less than a 10% interest in the company. These shareholders are grouped together as a notional single person in each company.

The shareholdings of the companies are as follows :

Shareholder	A Co (to 31/3/96)	B Co (1/4/96 on)	Continuity of voting interest
C	10%	45%	10%
D	50%	20%	20%
NSP	40%	35%	35%
			65%

If the notional single persons in A Co and B Co were not able to be treated as one single person for the purposes of calculating the loss continuity percentage after amalgamation, the 49% minimum would not be met. By treating the notional single person as the same person, the 49% continuity requirement is met.

Imputation credit accounts, etc

Amalgamating company's ICA, DWPA, BETA and PCA - section 191WD(26)

Subsection (26) provides that debit and credit balances in an amalgamating company's imputation credit

account, dividend withholding payment account, branch equivalent tax account and policyholder credit account are transferred to the equivalent account of the amalgamated company upon amalgamation. If the amalgamated company does not have a dividend withholding payment account or a policyholder credit account, the balances are transferred to the amalgamated company's imputation credit account.

Credits will be lost if the continuity of ownership requirement is not met. This requires at least 66% continuity of shareholding from the date that the credit arose until it is used by the amalgamated company. For the purposes of determining continuity from the date the credit arose until the date of amalgamation, the shareholdings of the amalgamating companies should be used.

Example

A Co and B Co amalgamate on 1/9/94. B Co remains as the amalgamated company.

Credits arose to the imputation credit account of A Co on 7/7/94.

The shareholdings of A Co and B Co from the date the credit arose until the date of amalgamation are as follows :

Shareholder	A Co	B Co (1/9/94)	Continuity of voting interest
C	30%	30%	30%
D	20%	45%	20%
E	50%	25%	25%
			75%

As the continuity of voting interests is 75%, the continuity of ownership test is met and the imputation credits may be transferred to the imputation credit account of B Co on amalgamation. A minimum of 66% continuity of shareholding from 7/7/94 will need to be maintained in order to use the credits.

Subsection (26)(b) provides that if a debit or credit would have arisen after the date of amalgamation to the account of an amalgamating company but for the amalgamation, the debit or credit will instead be recorded in the equivalent account of the amalgamated company.

Subsection (26)(c) provides that sections 394M and 394ZO, which limit the refund of tax to the credit balance in the imputation credit account or dividend withholding payment account, will apply to the amalgamated company as if the amalgamated company and amalgamating company were a single company.

Consolidated group's ICA, DWPA, BETA and PCA - section 191WD(27)

If a consolidated group amalgamates on a qualifying amalgamation which involves all members of the consolidated group and possibly one or more companies outside the consolidated group, the debit or credit balances in the consolidated group's imputation credit account, dividend withholding payment account, branch equivalent tax account or policyholder credit account will be transferred upon amalgamation to the equivalent account of the amalgamated company. If the amalgamated company does not have a dividend withholding payment account or a policyholder credit account, any balances in these accounts will be transferred to the amalgamated company's imputation credit account.

Any credits will be lost if the continuity of ownership requirements are not met; that is if there is not a minimum of 66% continuity of shareholding from the date the credit arose until it is used. For the purposes of calculating continuity before amalgamation, the shareholding of the consolidated group companies should be used.

Subsection (27)(b) provides that if a credit or debit would have arisen to the consolidated group account after amalgamation, it will be recorded in the equivalent account of the amalgamated company.

Subsection (27)(c) provides that for the purposes of refunds being limited to the credit balance in the consolidated group's imputation credit account or dividend withholding payment account under sections 394M and 394ZO, the amalgamated company and consolidated group should be treated as a single company from the date of amalgamation.

Amalgamation - goods and services tax

Consequential amendments have been made to the Goods and Services Tax Act 1985 (the GST Act). The GST amalgamation provisions are contained in a new section 61A.

Under section 61A(2) if an amalgamated company receives goods or services from an amalgamating company in the course of an amalgamation, the amalgamating company is deemed not to have made a supply of the goods and services and the amalgamated company is deemed not to have provided any consideration for them if either of these conditions are met:

- The amalgamated company is a registered person immediately after the amalgamation.
- An amalgamating company is not a registered person immediately before the amalgamation.

Accordingly, there will be no GST consequences.

For the purposes of calculating any adjustment for exempt supplies under section 21 of the GST Act, section 61A(2)(f) deems the amalgamated company to have acquired the goods and services at the same time and for the same cost and purpose as the amalgamating company originally did.

Under section 61A(3), if the amalgamated company acquires goods and services from the amalgamating

company, the goods and services are deemed to have been supplied by the amalgamating company and acquired by the amalgamated company at market value at the date of amalgamation if both of these conditions are met:

- The amalgamated company is not a registered person immediately after the amalgamation.
- The amalgamating company is a registered person immediately before the amalgamation.

Subsection 61A(4) provides that if an amalgamating company has provided fringe benefits or incurred entertainment expenditure in the period before amalgamation, with the result that it is deemed to have made a supply under section 21(3B) or 21(4) of the GST Act after it has ceased to exist, the supply will be deemed to have been made by the amalgamated company.

Under subsection 61A(5), if an amalgamating company would, but for the amalgamation, have been entitled under section 26 of the GST Act to a deduction against output tax for writing off a debt owed for the supply of goods and services, or if the amalgamating company is deemed to have made a taxable supply when a bad debt is recovered, the amalgamated company is entitled to that deduction or will be charged with that output tax.

Subsection 61A(6) provides that for the purposes of establishing whether an amalgamated company is liable to register for GST under section 51(1)(a) of the GST Act, all the supplies made by the amalgamating company before amalgamation are deemed to have been made by the amalgamated company.

Amalgamation - gift duty

Transferring assets from an amalgamating company to an amalgamated company may result in a dutiable gift arising as the amalgamating company does not receive any consideration from the amalgamated company. However, this generally will not reflect reality as the ultimate owners of the transferred assets (the shareholders in the amalgamating company) generally receive consideration for the amalgamation.

A new subsection 74C(1) of the Estate and Gift Duties Act 1968 therefore provides that no gift duty liability will arise if the gift occurs as part of an amalgamation and is between an amalgamating and amalgamated company. This exemption is not limited to gifts arising on a qualifying amalgamation as the transfer of assets and liabilities on a non-qualifying amalgamation is deemed to occur at market value for income tax purposes.

In addition, an exemption from gift duty is provided in subsection 74C(2) of the Estate and Gift Duties Act 1968 when a gift arises to an amalgamated company from a shareholder under the short form amalgamation method. A gift may arise under this method as the shares in the amalgamating company are deemed to be cancelled for no consideration.

Amalgamation - stamp duty

An amendment to section 13 of the Stamp and Cheque Duties Act 1971 provides that no stamp duty is payable on the transfer of assets occurring on a qualifying amalgamation.

Part 1C - terminology changes

Part 1C lists the changes in terminology made to the Revenue Acts to reflect company law reform. These changes have been made throughout the Revenue Acts:

- references to "winding up" and its variants have been replaced by references to **liquidation**;
- references to the "allotment" of shares have been omitted or replaced with the word "issue";
- references to Memorandum of Association or Articles of Association have been replaced with the term "constitution".

Other changes are more significant and are discussed in detail below.

"Close company" replaces "private company"

The Companies Act 1993 makes no distinction between private and public companies. References to "private company" have therefore been replaced in the Tax Act by references to **close company**, which is defined in section 2.

Broadly, a **close company** is a company that is ultimately controlled by 5 or fewer natural persons. More specifically, it is a company in which there are five or fewer natural persons

- whose aggregate **voting interests** (direct and indirect) exceed 50%, or
- if a **market value circumstance** exists, whose aggregate **market value interests** (direct and indirect) exceed 50%.

Associates are counted as one person for the purpose of the definition. The terms in bold type in the paragraph above are defined in sections 8B to 8D, and are used in several places in the Act to measure ownership or control of a company.

Special corporate entities (such as State Owned Enterprises) are not **close companies**.

*An important point to note is that **close company** does not have the same scope as **private company***. A private company was registered as such under the 1955 Companies Act, and could have up to 25 shareholders. A company owned equally by 20 shareholders may have been a private company but would not be a close company.

Example 1

A Co is a company in which there are 100 shares. A, B, C, D and E hold 10 shares each. B is A's wife. There are also 50 other shareholders, who hold one share each. Each share carries the same voting rights.

A and B are associated, so they count as one natural person. A Co. is a close company because five shareholders (A+B, C, D, E and one of the 50) own more than 50% of the voting rights in the company.

Example 2

G Co. is a listed company. H owns 30% of the shares, J owns 21%, and members of the public own the balance. All shares carry the same voting rights, so G Co is a close company.

Example 3

K Co. has 10 non-associated shareholders who each own 10% of the company. *K Co is not a close company*. This is because it is necessary to aggregate the interests of 6 shareholders in order to exceed 50%.

The substitution of **close company** for "private company" has occurred in the following sections.

"Major shareholder" definition - section 2

Section 2 now defines a "major shareholder" in relation to a **close company**. That definition is used in sections 374B(1)(g) and 374E(1) (Family Support provisions).

Realisation in the course of winding up - section 4A(10)

Section 4A(9) provides that when a company sells an asset to a related party, any profit is not a capital gain. Section 4A(10) states that this rule does not apply when a **close company** which is being liquidated sells an asset to a related non-corporate.

"Source deduction payment" definition - section 6

Section 6 provides that, in some instances, PAYE does not have to be deducted from salary paid to a shareholder/employee of a **close company**. The amendment is grandfathered - all private companies are deemed to be close companies until 1 April 1997 or reregistration under the Companies Act 1993.

The Government is considering extending the grandfathering to include all companies with 25 or fewer shareholders until 1 April 1997.

Section 147

Section 147 allows a deduction for cash donations by companies other than **close companies**. The change in scope of the section will mean that some companies that could previously deduct donations under section 147 will no longer be able to do so. However, there will also be other companies that are now able to claim a deduction, but which were ineligible in the past.

Section 194(2)

Section 194 provides a deduction for dividends paid on specified preference shares issued before 23 October 1986. However, a **close company** cannot claim a

deduction when it pays dividends on preference shares to a shareholder who also has shares of another class in the company. This exception will not apply if the Commissioner considers the terms of issue to be arm's length.

Sections 336N(1) and 336TB(1)

For fringe benefit tax purposes, a **shareholder-employee** is a shareholder and employee of a **close company**. This term is used in section 336TB. This section allows a close company that satisfies certain criteria to elect to pay fringe benefit tax annually on benefits provided to shareholder-employees. An effect of the change is that a company's entitlement to pay FBT annually may alter with changes in its shareholding.

Section 362(2)

Section 362(2) provides for the crediting of PAYE deductions against income tax. The proviso to this subsection specifies the maximum that can be credited against the income tax of a person who is an employee of, and associated with, a **close company**.

Sections 374B(1)(g) and 374E(1)

Section 374B calculates assessable income for the purposes of Family Support. Paragraph (g) attributes **close company** income to major shareholders.

The definition of "employment" in section 374E(1) (which relates to Guaranteed Minimum Family Income) targets activities from which a person derives source deduction payments. This does not include payments to major shareholders of **close companies**.

"Close company" replaces "proprietary company"

The definition of "proprietary company" has been repealed. In order to reduce the number of concepts of "small company" in the Act, **close company** replaces references to proprietary company in the sections listed below. *Again, there are differences in scope between "proprietary company" and "close company"*. A proprietary company was a company under the (direct) control of four or fewer persons (including corporates). A close company is a company controlled ultimately by five or fewer natural persons.

Section 4(1)(k)

Section 4(1)(k) provides that a dividend arises when a shareholder enjoys the benefit of expenditure by a **close company**, and the expenditure is not deductible.

Section 97(1)(a)

Section 97 allows the Commissioner to reallocate for tax purposes excessive remuneration paid by certain taxpayers to relatives. The provision does not apply to a **close company** which employs a relative of a director or shareholder (paragraph (a)). Section 190 applies to excess remuneration paid by a close company.

Section 151(2)

A **close company** is denied a deduction for any pension paid to a former employee who is or was a shareholder in the company, unless the Commissioner is satisfied that the former employee was a bona fide employee of the company and the size of the pension was similar to that which would have been arranged on an arm's length basis.

Section 190

Section 190 permits the Commissioner in certain cases to limit the deduction available for remuneration paid by a **close company** to a shareholder, director or one of their relatives to the extent that the Commissioner considers such remuneration to be excessive. The amount of remuneration which the Commissioner considers excessive is deemed to be a dividend paid by the company to the recipient.

"Widely held company" replaces "public company"

Inland Revenue Department Act - section 35

Section 35 of the Inland Revenue Department Act sets out the matters that may be received as evidence in Taxation Review Authority proceedings. Subsection (2) has been amended to replace the reference to "public company". The subsection now provides that the Authority may receive a copy of a persons's account with a **widely held company** if it is certified correct by a responsible officer of the company.

Control of a company and associated persons tests

The company control definition and the various associated persons definitions in the Revenue Acts have been replaced. These provisions measured a person's interest in a company by referring to the person's percentage of nominal capital or paid up capital in a company, and they are no longer appropriate. The Revenue Acts have been amended to instead use the measurement of shareholder interests rules contained in sections 8A to 8D of the Act. Under these rules, shareholders' economic interests in a company are generally measured by referring to their voting interests in the company. In limited circumstances, their interests are determined by the market value of their interest in a company.

Under section 8C a person's **voting interests** in a company equal the percentage of total **shareholder decision making rights** held by the person. These are rights to vote on distributions, the constitution, variation in the capital and election of directors.

When a **market value circumstance** exists, interest in a company is measured by reference to the market value of that person's shareholding in the company. Market value circumstance is defined in section 8B and applies in circumstances in which a shareholder's voting

interests in a company would not reflect that shareholder's interest in the company.

Section 7 - control of a company

Section 7 provides a standard definition of control of a company which is used throughout the Income Tax Act - there is no multiplicity of definitions as there is with associated persons.

The section has been replaced. Under the new section 7, a company is under the control of persons who meet any of these conditions:

- Together they hold more than 50% of the **direct voting interests** in the company.
- If a market value circumstance exists, together they have more than 50% of the **direct market value interests** in the company.
- They control the company by any other means.

Rights held by a nominee are deemed also to be held by the beneficial owner of the rights.

Note that the previous section 7(3) is no longer required because the term "proprietary company" no longer exists and its replacement **close company** does not refer to control of a company.

Associated persons tests

The following "associated persons" provisions in the Revenue Acts have been amended so that association is determined having regard to **voting interests** and **market value interests**. This includes direct and indirect interests. The associated persons tests differ throughout the Act and these amendments have not tried to bring the tests into line, but rather to retain the differences.

General associated persons rule - section 8

Section 8 defines when two persons are associated, for the purposes of the Income Tax Act. The section has been replaced because the basis upon which association was determined (the percentage of paid up capital and nominal value held by a shareholder) is no longer appropriate.

The new section 8 provides that two persons are associated in the following circumstances.

1. Two companies - section 8(1)(a)

Two companies are associated with each other if there is a group of shareholders who meet any of these conditions:

- Together they have 50% or more of the voting interests in each company.
- If a market value circumstance exists, together they have 50% or more of the market value interests in each company
- They have control of both companies by any other means.

This replaces previous sections 8(1)(a) and 7(4).

2. A company and a person - section 8(1)(b)

A company and a person other than a company are associated if the person meets either of these conditions:

- The person has a voting interest in the company of 25% or more.
- If a market value circumstance exists, the person has a market value interest in the company of 25% or more.

3. Relatives - section 8(1)(c)

Relatives are associated. **Relative** is defined in section 2.

4. Partnerships - section 8(1)(d)

A partnership and its partners are now associated. This is a new provision. As in the previous paragraph (d), a partnership is also associated with associates of a partner.

Nominees

The nominee provision in section 8(2)(b) has been redrafted but is essentially unchanged.

Profits from land transactions - section 67

Paragraphs (a) and (b) of section 67(2) have been replaced. For the purposes of section 67, two persons are associated with each other in the following circumstances.

1. Two companies - section 67(2)(a)

Two companies are associated with each other if there is a group of persons who meet either of these conditions:

- Together they hold 50% or more of the voting interests (or if a market value circumstance exists, the market value interests) in both companies.
- They otherwise have control of both companies.

2. Company and person other than a company - section 67(2)(b)

A company and a person other than a company are associated if that person (and/or the spouse or infant child of that person, or a trustee for either of them) meet either of these conditions:

- The person has 25% or more of the **voting interests** in the company.
- If a **market value circumstance** exists, the person has 25% or more of the **market value interests** in the company.

This paragraph differs from the section 8 equivalent.

The nominee provision in section 67(3) has also been redrafted but is substantially unchanged.

These changes may affect the liability of some taxpayers to tax on land sale profits.

Section 214E

Section 214E defines **associated persons** for the purposes of the petroleum mining regime. Paragraphs

(a) and (b) have been replaced and now provide that association is determined by referring to **voting interests** (or if a **market value circumstance** exists, **market value interests**) in, or control of, a company.

Section 245B

Section 245B defines associated persons for the purposes of the Controlled Foreign Company and Foreign Investment Fund regimes. Subparagraphs (a)(i) and (ii) have been replaced and new subparagraph (i) measures association of two companies by referring to **voting interests** or **market value interests** (if a **market value circumstance** exists) in each company or control of each company.

Section 245B(h)(ii) and (i)(ii) have been similarly amended.

Available subscribed capital per share

In the following sections the term **available subscribed capital per share** replaces references to the nominal capital, nominal value, paid up capital and paid up value of a share.

Income Tax Act

s.194(5)	Deductions for dividends paid on certain preference shares
s.195(2)	Interest on debentures issued in substitution for shares
s.197G(5)	Primary producer co-operative companies
s.197H(7)(a)	Cooperative dairy, milk marketing and pig marketing companies
s.245C(4)(a)	Calculation of control interest
s.245D(2)(a)	Calculation of income interest
s.245E(1)(a)	Variation in control or income interests
s.245GA(13)	Calculation and attribution of CFC repatriation

Estate and Gift Duties Act

s.75(1)(b) and (c)	Exemption for certain payments by employers

Shares of the same class

Section 393N(b) (which in effect provides that a loss attributing qualifying company may have only one class of shares) and paragraph (b) of the definition of **shares of the same class** in section 4A(2) have been redrafted to remove references to paid-up capital and share premium and substitute more appropriate terminology.

International tax amendments

Controlled foreign companies

Application of new controlled foreign company definition - section 38(3), Income Tax Amendment Act (No. 2) 1993

The new controlled foreign company (CFC) definition was enacted in 1993. Its application date has been amended to ensure that non-standard balance date joint venture (i.e., 50% NZ resident/50% non-resident ownership) companies which are resident in 17th Schedule jurisdictions remain subject to the CFC regime for their accounting periods spanning 31 March 1993. Such companies will be subject to the foreign investment fund (FIF) rules in subsequent accounting periods. Before this amendment, 17th Schedule joint venture companies with accounting periods spanning 31 March 1993 fell outside the international tax regime for that part of their accounting period which fell before 1 April 1993.

Manipulation of measurement date options - section 245A(4)

An anti-avoidance rule has been added to the CFC and FIF regimes to prevent the manipulation of measurement date options by associated persons.

The anti-avoidance rule will allow the Commissioner to disregard, or deem to be made, elections regarding the daily, quarterly or annual measurement of interests in CFCs and FIFs to ensure that transfers of interests between associated persons cannot be used in combination with certain elections to avoid the application of the CFC and FIF regimes.

The amendment applies to CFCs for their accounting periods ending on or after 14 September 1994. For FIFs, it applies from the start of the new FIF regime which was enacted by the Income Tax Amendment Act (No. 2) 1993 (i.e., generally from 1 April 1993).

Calculating indirect control interests - section 245C(5)

In 1993, a new CFC definition was enacted to include de facto control tests. These de facto control tests provide that a foreign company is a CFC if either of these conditions are met:

- A single New Zealand resident holds control interests in the company of at least 40 percent, unless a non-resident who is not associated with the New Zealand resident has a control interest equal to or greater than the New Zealand resident's interest.

- A group of five or fewer New Zealand residents can control the company's shareholder decision-making rights, thereby ensuring that the affairs of the company are conducted in accordance with the wishes of that group.

The provision dealing with calculating indirect control interests which is used to determine whether second and subsequent tier foreign companies are CFCs (section 245C(5)) has been amended to incorporate the above de facto control CFC tests.

Attributed foreign losses - section 245M

Section 245M deals with the carrying forward and offsetting of attributed foreign losses against attributed foreign income and FIF income calculated under the branch equivalent method. It has been amended to clarify that there is no time limit to the carrying forward of attributed foreign losses.

Foreign investment funds

Cost measurement rules for share splits - section 245R(2)

The FIF cost measurement rules applying to share splits and non-taxable bonus issues have been clarified.

If a person who holds shares in a company receives further shares in the company by way of a share split or a non-taxable bonus issue, for the purposes of the FIF regime a proportion of the expenditure incurred in acquiring the person's original shares is attributed to the new shares. The amendment ensures that the additional expenditure which is deemed to be incurred with respect to the new shares will not reduce FIF income calculated under the comparative value or deemed rate of return methods, as this expenditure has already been claimed by the taxpayer in an earlier income year.

Deemed rate of return method requirements - section 245RC(3)

Section 245RC(3) lists the circumstances in which the deemed rate of return method of calculating FIF income or loss may be used. Previously, one of these circumstances entitled a natural person whose FIF interests did not have an aggregate market value of more than $100,000 to use this method.

As a compliance cost saving measure, natural persons who use the deemed rate of return method for all their FIF interests may now use this method if the aggregate book value of their interests does not exceed $100,000 (the aggregate market value provision remains for all other cases). This amendment allows people who are using only the deemed rate of return method to refer to existing information rather than having to separately ascertain the market value of their interests.

Accounting profits method requirements - section 245RC(6)

An amendment has been made to clarify that if a person uses the accounting profits method to calculate FIF income or loss, the FIF's net after-tax accounting profits or losses must be calculated on a consolidated basis if the FIF has any subsidiaries. This means that the income of second and subsequent tier subsidiaries must be included in the financial accounts of a first tier FIF for which the accounting profits method is used.

Accounting profits method: 31 March election option - section 245RF(2)

Persons who use the accounting profits method for a FIF interest may elect that their income interests are only measured on 31 March instead of the last day of each quarter. An amendment has been made to limit the 31 March election option to cases in which the FIF interest is held for more than one year. This amendment is additional to the amendment described above which limits the manipulation of measurement date options by associated persons (section 245A(4)).

Branch equivalent method: second tier FIF interests - section 245RG

A technical deficiency in the branch equivalent method for calculating FIF income or loss has been corrected to ensure that underlying FIF interests held by a FIF (for which the branch equivalent method is used) are taken into account.

Section 245J(25) (as modified by section 245RG(1)) provides that second tier FIF income is to be treated separately from the branch equivalent income of a first tier FIF, and that the New Zealand shareholder is responsible for choosing the FIF income calculation method for the second tier FIF. Section 245G(6) (as modified by section 245RG(2)) then directly attributes a proportionate share of the second tier FIF income to the New Zealand shareholder in the first tier FIF.

Before this amendment, a taxpayer who used the branch equivalent method to calculate FIF income or loss from a first tier FIF did not have to attribute income of a lower tier entity that was more than 50 percent owned by the first tier FIF. This was a result of a mismatch between section 245J(25) (as modified by section 245RG(1)) and the FIF interest definition in section 245RA (in particular, the exclusion of 10 percent or greater income interests in CFCs in section 245RA(2)(a)).

Previously, the look-through and direct attribution rules for first tier FIF interests (for which the branch equivalent method was used) were only effective in the case of second tier FIFs that were 50 percent or less owned by a first tier FIF.

The branch equivalent method for calculating FIF income and loss has now been amended to ensure that the FIF look-through and direct attribution rules apply to all second tier FIF interests held by first tier FIFs for which the branch equivalent method is used.

The amendment applies to FIF accounting periods ending after 2 June 1994.

Taxation of distributions from FIFs - section 245RI

When a person calculates FIF income or loss using the comparative value or deemed rate of return methods, no dividend or assessable income is derived under the other provisions of the Income Tax Act (section 245RB(6)). This rule is subject to section 245RI under which aggregate dividends in excess of total FIF income may be assessable.

Section 245RI has been amended to remove a drafting circularity by distinguishing between gains which are deemed to be FIF income under section 245RI and other FIF income.

Section 245RI has also been amended to clarify that the prior gains taken into account should be only those gains that would have been a dividend or assessable income were it not for the FIF regime.

Application date

With the exception of the amendment to section 245RG, the above FIF related amendments have the same application date (generally 1 April 1993) as the new FIF regime which was enacted by the Income Tax Act Amendment (No. 2) 1993.

Foreign investor tax credit regime

The foreign investor tax credit regime in section 308A contains two safe harbour rules which protect a company from penalties for underpayment of tax. These penalties could be imposed if the company claims a tax credit under the regime through treating a shareholder as a non-resident portfolio investor, and it turns out that the shareholder does not in fact qualify. Briefly, these safe harbour rules apply in two situations:

- if shareholders provide a notice to the company stating that they are non-resident portfolio investors (defined as investors who are not resident in New Zealand and who hold less than 10 percent interests in a New Zealand company)
- if the shareholders do in fact hold less than 10 percent interests in the company and the company has no reason to believe the shareholder is not non-resident.

Previously, the Act only provided for the repayment of the tax credit by a shareholder which notified the company in writing that it qualified as a non-resident portfolio investor (the first safe harbour category), when in fact the shareholder did not qualify.

Section 308A(6) has been amended to provide that a shareholder who qualifies under either of the above safe harbour rules is liable to the repayment of the tax credit allowed to the company if it is in fact not a non-resident portfolio investor. Therefore, a New Zealand resident shareholder who invests in a New Zealand company through a non-resident nominee will be required to repay the foreign investor tax credit allowed to the company by its reliance on the foreign address of the nominee.

Two other minor amendments have been made to the foreign investor tax credit regime in section 308A. First, a minor drafting error in the formula in subsection (2) (dealing with the calculation of the company tax credit when dividend withholding payment credits are attached to a dividend) is corrected. Second, a wrong section cross-reference in subsection (3) is also corrected.

Application date

The amendments to the foreign investor tax credit regime apply to dividends paid on or after 14 September 1994.

Underlying foreign tax credit (UFTC) regime

Dividends from lower tier companies - sections 394ZMA(3) and 394ZMD

Sections 394ZMA(3) and 394ZMD have been amended to allow taxes paid by a lower tier New Zealand company to be claimed as an UFTC.

If the New Zealand company has to maintain an imputation credit account (ICA), the amount of the UFTC cannot exceed the imputation credits attached to the dividend paid. This makes sure that the New Zealand company cannot pass on a double benefit of imputation credits and foreign tax credits from the same New Zealand taxes paid.

If the New Zealand company cannot maintain an ICA, there is no restriction on the amount of UFTCs it may distribute.

This amendment will apply to all dividends paid on or after 28 September 1993.

Interest paid in conduit financing arrangements - section 394ZMH

Section 394ZMH is an anti-avoidance rule in the UFTC regime to stop foreign investors from using New Zealand as a conduit for investing in a grey list country. Such transactions involve a New Zealand company receiving dividends from a grey list company and paying interest to another foreign company.

As originally drafted, this rule did not apply when the payer of the dividend or the foreign company receiving the interest was a controlled foreign company (CFC).

This rule has been amended so that it will no longer apply if only the recipient of the interest is a CFC. (It will still apply if the payer of the dividend is a CFC.)

This amendment will apply to all dividends paid on or after 28 September 1993.

Branch equivalent tax accounts

Credits arising to branch equivalent tax accounts of companies - section 394ZZP(1)

Section 394ZZP(1) provides for credits to arise in a company's branch equivalent tax account (BETA) in certain situations. It has been amended to ensure that a double credit does not arise in a company's BETA if a BETA debit balance (arising from FDWP paid) is offset against New Zealand income tax on attributed foreign income.

Before this amendment, if a company used a debit balance (arising from FDWP paid) in its BETA to pay an attributed foreign income tax liability, paragraphs (a) and (c) of section 394ZZP(1) allowed a credit to arise to the company's BETA account twice for the one transaction. Paragraph (a) provided for a credit to arise for the amount of income tax payable on the company's attributed foreign income. Paragraph (c) provided for a credit to arise equal to the amount of the debit balance used to meet an attributed foreign income tax liability. The policy intention was that only one credit should arise. The amendment achieves this by reducing the credit entry arising under paragraph (a) of section 394ZZP(1) by the amount of the BETA debit balance used to offset any attributed foreign income tax liability.

The amendment applies from 28 September 1993, which is when the revamped BETA provisions (which allow a BETA debit balance arising from FDWP paid to be offset against an attributed foreign income tax liability) came into force.

Credits and debits arising to BETA - section 394ZZP(2)

A technical change to the BETA credits mechanism was made last year by the Income Tax Amendment Act (No.3) 1993 from 28 September 1993. This change replaced the mechanism of transferring credits from the BETA to the imputation credit account (ICA). Instead, tax paid on attributed foreign income would be credited to the ICA immediately. A declaratory provision for section 394D was therefore required to credit the ICA with pre-effective date BETA credits as at 28 September 1993.

A drafting error in this provision allowed credits in the BETA which originated from a reduction of an available loss to be transferred to the ICA. In the past, credits to the ICA which have resulted from the reduction of available losses have never been able to be transferred to the ICA. The Minister of Revenue issued a press statement on 28 March 1994 to advise taxpayers of this drafting error.

Section 394ZZP(2) therefore requires taxpayers who have loss credits in their BETAs as at 28 March 1994 to remove those credits. This is achieved by debiting the ICA by the amount of loss credits which exist at 28 March 1994 by applying the procedures set out in section 394ZZP(6)(c) of the Act.

This section is deemed to have come into force on 28 March 1994.

BETA credit offset restriction - sections 394ZZQ and 394ZZV

Section 394ZZQ(3) permits a company to use a BETA credit balance to offset a FDWP liability. An amendment has been made to limit when offsets are permitted:

- If a BETA credit balance arises from income tax payable on attributed foreign income, the BETA credit offset is only permitted if the company has paid income tax (including provisional tax) for the income year equal to the amount of the credit offset (Inland Revenue will treat any income tax paid as being first paid in respect of attributed foreign income).
- If a BETA credit balance arises from the utilisation of losses, the BETA credit offset is only permitted if the Commissioner has made an assessment or determination of loss for the income year in which the relevant attributed foreign income is derived.

The amendment effectively ensures equal treatment of the BETA credits of companies and individuals. Individuals have always only been allowed to offset BETA credits against income tax payable on foreign dividends when they have paid the tax on attributed foreign income (giving rise to the BETA credits).

The amendment to section 394ZZQ applies to any FDWP due on or after 14 September 1994.

An amendment has been made to section 394ZZV which relates to the utilisation of BETA credit balances by individuals. It aligns that provision with the changes made to the company BETA credit offset rules in section 394ZZQ. The amendment applies from the 1994/95 income year.

Minor drafting changes - sections 245G(5), 245G(6), 245R(4), 245RB(11) and 245RC(6)

A number of minor drafting changes have also been made to the international tax regime to improve the clarity and consistency of the legislation.

Zero-rating of goods situated outside New Zealand at the time of supply

Section 11(1)(b), GST Act

Background

After a 1992 amendment, section 11(1)(b) of the GST Act provided that the supply of goods could be zero-rated if the goods were not situated in New Zealand at the time of supply.

This created a loophole which allowed for the zero-rating in certain situations of goods purchased for consumption within New Zealand. This would apply when a customer ordered goods which were to be imported into New Zealand by the supplier. The supply to the customer was zero-rated because the goods were outside New Zealand at the time of supply. The supplier paid GST at the border when the goods were imported, but could claim an input tax credit. The supply was therefore effectively zero-rated even though the supply took place in New Zealand.

Issue

The amendment closes this loophole by providing that zero-rating applies when goods are situated outside New Zealand at the time of supply and are not to be imported into New Zealand by the supplier of the goods.

Application date

The amendment applies to supplies made on or after 14 December 1992, other than supplies that have been zero-rated in accordance with the legislation as it was before this amendment and included in a return furnished on or before one of these dates:

- the due date for the return, if the supply was made in a taxable period for which the due date for furnishing the return falls after 7 July 1994
- 7 July 1994, in any other case.

Accounting for goods and services tax

Section 140B, Income Tax Act 1976

Introduction

Section 140B of the Income Tax Act deals with the income tax treatment of goods and services tax. It has been amended to clarify the income tax treatment of GST secondhand goods input tax credits.

Issue

Section 140B(3) provides that generally no income tax deduction can be claimed for GST input tax. The subsection as previously worded referred to "input tax charged". The amendment now refers to "input tax charged, levied or calculated" to make it clear that no income tax deduction can be claimed for secondhand goods input tax credits.

Application date

The amendment applies to input tax levied or calculated on or after 1 October 1986, except when notional secondhand goods input tax has been claimed as a deduction from assessable income in a tax return furnished to the Commissioner before 2 June 1994.

Depreciation changes

Section 140B has also been amended to update references to the depreciation provisions.

- The reference to the first proviso to section 108 has been removed from subsection (4)(d).
- In subsection 7(d), the words "to which subsections (7) and (8) of section 117 refer" have been replaced with the words "in respect of any item of depreciable property (as defined in section 107A of this Act)".

These amendments to section 140B apply from 14 September 1994.

Dairy companies - capital cost deduction repealed

Section 167 has been repealed. That section permitted merging co-operative dairy companies to deduct certain capital costs, losses and reserves that would otherwise be non-deductible.

The repeal of this section applies from the 1994/95 income year.

GST and sail-away boats

Section 11(1)(b), GST Act

Introduction

This amendment provides that boats that have been purchased in New Zealand and are sailed out of New Zealand by the purchaser can be zero-rated for GST purposes.

Background

The zero-rating provisions of the GST Act did not allow for the zero-rating of boats which were sailed out of New Zealand by the purchaser. These boats were effectively being exported. However, the usual zero-rating provisions did not apply because the boats were not being exported by the supplier.

Issues

Section 11(1) has been amended to allow for zero-rating of such supplies by adding paragraph (ag). Paragraph (ag) provides that the supply by way of sale of a boat to a recipient who exports that boat under its own power to a place outside New Zealand can be zero-rated.

Section 11(1)(ag) is subject to subsection (1E) which provides that both of these conditions must be met to obtain zero-rating:

- The boat must be exported within sixty days of the recipient or recipient's agent taking physical possession.
- The supplier must keep the necessary documentation.

Under section 11(1F) the Commissioner can extend the sixty day period, if the purchaser applies in writing and the Commissioner is satisfied that circumstances beyond the control of the supplier and recipient prevent the export of the boat within that period.

The supplier must keep the following documentation to support zero-rating:

- a written statement from the purchaser that the boat is not intended for use within New Zealand and that the boat will be exported from New Zealand
- a written statement from the purchaser that the boat will not be hired, given away, offered for sale, used as security or otherwise disposed of while it is in New Zealand
- a record of the sale
- a copy of the clearance document issued to the purchaser by New Zealand Customs upon leaving New Zealand (Regulation Form 8 - Certificate of Clearance) or other documentation which proves that the boat has left New Zealand.

Application date

The amendment applies to supplies made on or after 14 September 1994.

Provisional tax

Introduction

There have been a number of minor amendments to confirm the policy underlying the provisional tax regime. A number of minor drafting errors have also been corrected.

Confirmation of when remission applies

The most significant amendment is to section 386, to confirm that only those with over $300,000 residual income tax qualify for remission under subsection (2) of that section. As part of the introduction of the new use-of-money interest regime, the Government reviewed the issue of those taxpayers who underestimate their income as a result of a major fluctuation in income towards the end of the income year. A provision which was intended only for those with over $300,000 residual income tax and who meet certain other criteria was introduced. An amendment to section 386(2) confirms this position.

Minor amendments

A number of minor drafting corrections have been made to the provisional tax regime:

- Section 375 is amended to correct a reference in the definition of the term "residual income tax". The definition now refers to section 245L(1) rather than section 245(1).
- Section 378 is amended to confirm that taxpayers who do not expect their residual income tax liability to exceed $300,000 but who are determined on assessment to have a liability exceeding $300,000 had an obligation to estimate their liability before the third instalment date and therefore can have underestimation penalty imposed if the amount paid by that instalment date is insufficient (this simply confirms existing practice).
- Section 385(1)(b) is amended to ensure that it refers to section 379 rather than section 378.

The application date for the provisional tax amendments is the 1994-95 income year and all subsequent income years.

Introduction

Several Amendment Acts were enacted on 14 September 1994. They resulted from the Taxation Reform (Companies and Other Matters) Bill, introduced into Parliament in June 1994. The Amendment Acts are:

- Income Tax Amendment Act 1994
- Goods and Services Tax Amendment Act 1994
- Estate and Gift Duties Amendment Act 1994
- Stamp and Cheque Duties Amendment Act 1994
- Inland Revenue Department Amendment Act 1994
- Companies Act 1955 Amendment Act (No.3) 1994
- Companies Act 1993 Amendment Act (No.2) 1994

The main function of the new legislation is to update the Revenue Acts to provide for the tax consequences of company law reform.

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The proposed amendments to prevent the abuse of foreign tax credits which were originally part of the Taxation Reform (Companies and Other Matters) Bill were split off into the separate Income Tax Amendment Bill, which remains with the Finance and Expenditure Select Committee.

New tax bill information service

A new publication will soon be available for people who like to consider proposed tax legislation that is not yet passed into law.

Starting with the next tax bill that is introduced into Parliament, detailed commentary setting out the policy intent of the measures proposed in bills will be sent to interested taxpayers who ask for it.

If you or your firm would like to receive this commentary, please write to:

Legislative Affairs
Inland Revenue Department
P O Box 2198
WELLINGTON or fax (04) 474 7217

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This Tax Information Bulletin deals with recent tax legislation. It covers these Acts:

- Income Tax Amendment Act 1994
- Goods and Services Tax Amendment Act 1994
- Estate and Gift Duties Amendment Act 1994
- Stamp and Cheque Duties Amendment Act 1994
- Inland Revenue Department Amendment Act 1994

These Amendment Acts were enacted on 14 September 1994. They resulted from the Taxation Reform (Companies and Other Matters) Bill, which was introduced into Parliament in June 1994.

This Tax Information Bulletin does not include the regular “Questions we’ve been asked” or “Legal decisions - case notes” sections. These will reappear in the next TIB.

This TIB has no appendix