CONSULTATION> OFFICIALS' ISSUES PAPER

Improving taxation of loans made by companies to shareholders

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An officials' issues paper

Inland Revenue
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Making a submission

Inland Revenue invites submissions on the issues raised in this document, including the specific questions asked and any other issues relevant for officials to consider. A complete list of these questions can be found in the Appendix to this issues paper.

Include in your submission a brief summary of the major points and recommendations you have made. Please indicate if officials from Inland Revenue can contact you to discuss the points raised, if required.

The closing date for submissions is 5 February 2026.

Submissions can be made:

- by email to policy.webmaster@ird.govt.nz with "Improving taxation of loans made by companies to shareholders" in the subject line, or
- by post to:

  Improving taxation of loans made by companies to shareholders
  C/- Deputy Commissioner, Policy
  Inland Revenue Department
  PO Box 2198
  Wellington 6140

Privacy of submissions

Submissions may be requested under the Official Information Act 1982. Please clearly indicate in your submission if you consider that any information should be withheld on the grounds of privacy, or for any other reason. Contact information such as an address, email, and phone number for submissions from individuals will be withheld. Whether any information is withheld will be determined using the Official Information Act 1982.

Contents

Chapter 1 – Introduction

1.1 This issues paper discusses Inland Revenue's concerns with the tax treatment of shareholder loans. In doing so, it explores the current law, Inland Revenue data and international treatment. In this issues paper, "shareholder loans" means any amount loaned by a company to a shareholder, including formally documented loans and overdrawn current accounts.

1.2 Shareholder loans are a legitimate and widely used transaction among small businesses and close companies to manage cashflow while providing funds from the company to a shareholder. While most companies use shareholder loans responsibly, Inland Revenue's data has revealed some very large outstanding loans from companies to their shareholders.

1.3 Inland Revenue is concerned that the current tax rules for taxing shareholder loans are inadequate and make the tax system less fair and efficient. When a shareholder borrows a large amount from their company and does not promptly pay it back, they can pay less tax compared to shareholders in other companies who receive taxable dividends or taxpayers who earn income as sole traders, partners or salaries.

1.4 This is because when shareholders receive dividends and other payments from their companies, the funds are fully taxed at the shareholder's marginal rate (up to 39%). In contrast, when a shareholder receives funds from their company in the form of a loan, the company will often only be required to pay a small amount of tax on the loan interest each year.

1.5 In addition, Inland Revenue is concerned the current rules often fail to collect tax on the funds left in the hands of the shareholder when a company is wound up. This is because the rules do not provide a clear date for when income arises on outstanding loans when the lending company is removed from the Companies Register.

1.6 This issues paper proposes measures that could be implemented to improve the taxation of shareholder loans. The main proposal is to treat loans made on or after the date of publication of this issues paper as income if they exceed a de minimis threshold and are not repaid within a set period of time, consistent with the approach of other countries.

1.7 The time limit would apply only to new lending. It would not impose a time limit on existing loans and would not tax amounts that have been previously borrowed under the current law, unless there was a material variation to the terms of that existing loan. It would also only apply if the company's total lending to their shareholders was over a certain threshold (for example, $50,000), so small, short-term lending for cashflow is not affected.

1.8 To minimise integrity concerns and structuring opportunities, Inland Revenue proposes that, if enacted, the measures discussed in this issues paper should apply from the date of publication of this issues paper.

1.9 This issues paper seeks comments from submitters on our view of the problem and the proposed solutions.

Background

1.10 A business can be carried on through a variety of legal forms such as sole trader, partnership, company or trust. Each has different legal characteristics, which lead to different tax outcomes. For a company, the most relevant legal characteristics are that the company is a separate legal entity from its shareholders and the shareholders, in most cases, have no liability for the debts of the company.

1.11 Shareholder loans are a common and well-established commercial mechanism, especially in close companies and small businesses.[1] Shareholder loans are used by close companies in a variety of contexts for many different reasons. They can range in formality and complexity and include any form of lending from a company to a shareholder, from a temporarily overdrawn shareholder current account to a long-term loan on commercial terms.

1.12 Shareholder loans enable companies and shareholders to efficiently manage their cashflows and often require less formal business processes compared with the payment of a dividend or salary. In addition, shareholder loans have the advantage that funds can be received without immediate tax consequences for the shareholder.

1.13 Short-term shareholder loans, such as a temporarily overdrawn shareholder current account, provide flexibility for the company and shareholder and are a simple way of managing short-term funding requirements. A shareholder current account is a record of the net balance of funds the shareholder has loaned to and withdrawn or borrowed from a company. Over a year, a shareholder often takes drawings from a company to cover their private spending or living costs. For example, a shareholder might use a company credit card to pay a personal expense. These drawings are usually taken before the shareholder gets income such as salary, dividends or interest from the company, which results in the shareholder current account becoming overdrawn.

1.14 In most cases, income will regularly be credited to the shareholder current account to repay the overdrawn balance. In some cases, however, the shareholder will be unable to repay the balance and the amount will remain outstanding (and will be a shareholder loan). If no credits are made in a timely manner, an overdrawn shareholder current account can quickly become unmanageable, especially for companies that are struggling. When a current account is overdrawn for an extended period, it seems unlikely that the shareholder will be able to repay the amount, indicating that the company has permanently transferred value to the shareholder.

[1] A "close company" is a company with five or fewer natural person or trustee shareholders who own at least 50% of the company.

1.15 Longer-term shareholder loans may be used when the company has excess funds that it does not immediately need for business purposes, such as funds arising from the sale of a capital asset.

Current tax treatment

1.16 A company is a separate entity from its shareholders so its income is reported separately, with company profits taxed at the corporate tax rate (28%).

1.17 A company can distribute its profits, or any other amount allowed by company law, to shareholders by paying a dividend. Under current tax law, a dividend paid by a company to a shareholder is income to the shareholder and resident withholding tax is withheld at the shareholder's marginal tax rate. Under New Zealand's imputation system, when a company pays a dividend, imputation credits can be attached that give the shareholder a credit for the company tax already paid.

1.18 The difference between the 28% corporate tax rate and the higher marginal tax rates applying to natural persons and trustees means that for many shareholders additional tax will be payable on the dividend; either in the form of top-up tax (for imputed dividends), or at full marginal rates (for unimputed dividends). Given current tax rates, the amount of top-up tax can be significant (for a shareholder with a 39% marginal tax rate receiving a fully imputed dividend, the amount of top-up tax will be 11% of the grossed-up dividend, or approximately 15% of the cash dividend).[2]

1.19 In contrast to dividends, shareholder loans do not generally result in taxable income for the shareholder. A shareholder loan will generally only result in tax for the shareholder to the extent that interest on the loan is less than a prescribed interest rate (when a taxable dividend is deemed to arise on the difference), or if repayment is not required and the loan is forgiven.

Concerns with current law

1.20 Inland Revenue is concerned that the way shareholder loans are taxed, together with the differences in tax rates, means that the current tax system provides an unintended tax advantage when companies lend funds to shareholders, compared with paying taxable dividends.

1.21 We consider that the current tax treatment of shareholder loans results in a less efficient taxation system, lower revenue raised and creates horizontal and vertical inequities. The current rules are unfair to shareholders who receive dividends or salaries, partners, sole

[2] For example, a shareholder with at least $180,000 of other income receives a $100 fully imputed dividend. The shareholder receives $72 cash and $28 imputation credits. The shareholder's tax liability in total is $39, which means they will have an additional tax liability of $11. $11 is 15.28% of the cash dividend of $72.

traders and employees, who will typically be taxed at a higher marginal tax rate (33% or 39%) at the time they receive the income.

1.22 For the income year ended 31 March 2024, Inland Revenue data shows approximately 119,000 companies were owed a total of nearly $29 billion by shareholders who were natural persons or trustees. While half of these companies had outstanding loan balances of less than $50,000, some companies had made very large loans. About 5,550 companies had outstanding loan balances of more than $1 million and 540 companies had outstanding loan balances of more than $5 million. The data suggests that the amount of shareholder loans is generally increasing over time, but that the amount is also responsive to changes in the wider tax system (for example, changes in the trustee tax rate).

1.23 We are concerned that the high value of shareholder loans suggests that our current rules relating to shareholder loans are less effective than rules in other jurisdictions at requiring the loan be repaid within a certain period of time or before the company goes out of existence. This can result in the tax advantage becoming a permanent advantage for the shareholder if the loan is never repaid.

1.24 Inland Revenue data also shows that over a six-year period from 1 April 2019 to early 2025 nearly 15% of all companies removed from the Companies Register were owed money by their shareholders at the time they were removed. In aggregate, those companies were owed over $2 billion by their shareholders.

1.25 The existence of shareholder loans is a common feature in public reporting of individual company failures. This can undermine public confidence in the tax system and the perceived fairness of limited liability owner-operated companies. Media reporting of significant or high-profile liquidations often describes large shareholder loan balances, significant tax debt including PAYE and GST, as well as debts to other creditors. The existence of unrepaid shareholder loans can be a reason why a company is unable to pay its creditors or Inland Revenue when the company is liquidated.

1.26 Shareholder loans may also result in some shareholders having lower reported income and remaining on a lower marginal tax rate. As a result, they could potentially access government support and services that are targeted by income, which they would not be eligible for if they had received funds as a dividend or salary.

1.27 Inland Revenue does not have similar concerns with businesses operated by sole traders, partnerships or look-through companies because, for tax purposes, those business profits are earned by the owner and taxed at the owner's marginal tax rate. Similarly, widely-held companies do not typically distribute their profits by way of loan. Instead, widely-held companies tend to have more formal processes in place and, when they decide to distribute their profits to shareholders, will declare dividends that are taxed at the shareholder's marginal tax rate.

Proposals in this issues paper

1.28 This issues paper proposes three measures that aim to improve the integrity of our tax system, improve compliance, and enable more effective audit and review by Inland Revenue. The proposals will do this by making clear rules that apply to everyone in the same way.

1.29 The main proposal, discussed in Chapter 6, is to treat certain shareholder loans that exceed a de minimis threshold (such as $50,000 per company) as dividends if the loan is not repaid within a set period of time. This proposal would only apply to amounts loaned on or after the publication date of this issues paper. This should ensure the proposed reform would not create a new cashflow pressure on shareholders who have previously borrowed from their companies.

1.30 In Chapter 7 we propose that any shareholder loans that remain outstanding at the time that a company is removed from the Companies Register should be treated as income of the shareholder. This proposal would apply to any company removed from the Companies Register on or after the date of publication of this issues paper.

1.31 Finally, in Chapter 8, we propose new record-keeping and reporting requirements for available subscribed capital (ASC) and the available capital distribution amount (ACDA).

1.32 In addition to these potential changes, Inland Revenue is currently working on non-legislative solutions to improve our processes for collecting tax from shareholders who have shareholder loans when companies are removed from the Companies Register. These solutions will better utilise the capabilities of our system and will complement the proposals in this issues paper.

1.33 We expect that, if implemented, the measures in this issues paper would encourage the timely repayment of shareholder loans and reduce the use of long-term company loans to shareholders. This is expected to increase the funds available to a company to invest in its business. It may also reduce the likelihood of a liquidation and could potentially increase the amount that can be used to pay Inland Revenue and other creditors if a liquidation occurs.

Feedback sought

1.34 We welcome feedback on whether submitters share our concerns with the current tax treatment of shareholder loans, the scope of the problem, our policy proposals, alternative options, and how the proposals could be improved to ensure they do not impose undue costs on the affected taxpayers.

Summary of proposals

1.35 The table below sets out the main policy proposals included in this document.

Treating shareholder loans as dividend if not repaid within set period of time	
We propose to treat new loans by a company to a shareholder as a dividend if the loan is not repaid within a set period of time, subject to a de minimis threshold and other exceptions.	Chapter 6 Page 38
Treating outstanding shareholder loans as shareholder income when company removed from Companies Register	
We propose that when a company is removed from the Companies Register with an outstanding shareholder loan, the amount of the loan will be treated as income at that time (if not already treated as a dividend by first proposal).	Chapter 7 Page 48
Improving record-keeping and reporting requirements	
We propose new record-keeping and reporting requirements for ASC and ACDA.	Chapter 8 Page 52

Document outline

Chapter	Outline
2	**Context and background – current law**: A discussion of the current treatment of payments made by a company to a shareholder, including shareholder loans.
3	**Inland Revenue data on shareholder loans:** A discussion of Inland Revenue's data.
4	**Summary of problem:** A discussion of our concerns about the current taxation of shareholder loans.
5	**International treatment of shareholder loans**: A summary of the rules in other jurisdictions that treat shareholder loans as a dividend.
6	**Shareholder loans treated as dividend:** A proposal to treat new shareholder loans as a dividend if they exceed a de minimis threshold and are not repaid within a set period of time.
7	**Outstanding shareholder loans treated as shareholder income once company ceases:** A proposal to treat any outstanding shareholder loan as income of the shareholder if the company is removed from the Companies Register.
8	**Improving record keeping and reporting:** Proposals to improve record keeping and reporting for ASC and ACDA.
9	**Treaty of Waitangi considerations**
Appendix	**Questions for submitters**

Chapter 2 – Context and background – current law

2.1 In this chapter we describe the current tax treatment of different ways companies can provide funds to shareholders. As a general proposition, company funds can be provided to a shareholder as a:

- dividend
- return of equity or debt capital
- payment (potentially at more or less than market value) for goods or services provided by the shareholder to the company (this can include shareholder remuneration), or
- shareholder loan.

2.2 In addition, on liquidation the remaining assets of a company after creditors are paid will be distributed to shareholders.

2.3 This chapter also describes the current record-keeping requirements for available subscribed capital (ASC) and the available capital distribution amount (ACDA).

Dividends

2.4 The Companies Act 1993 gives the directors of a company the power to authorise a dividend (and certain other payments to shareholders). The Companies Act requires that before they authorise a dividend, the directors must be satisfied that the company will be solvent after the dividend is paid. The solvency requirement is critical for the protection of the company's creditors. Under company law, a shareholder who receives a properly made dividend has no liability to repay the dividend.

2.5 The tax law definition of a dividend is significantly broader than the company law concept. For tax purposes, a dividend includes any transfer of value from a company to a shareholder that is caused by the shareholding relationship (subject to certain exceptions). Unlike company law, the tax law definition of a dividend is not concerned with protecting company creditors, but only about whether value has been transferred by the company to the shareholder because of their shareholding.

2.6 For income tax purposes, a dividend is generally treated as income to the shareholder and not deductible to the paying company (because it is not expenditure incurred to derive income). Dividends are paid out of a company's after-tax profit and, under New Zealand's imputation system, a company can attach an imputation credit to the dividend that allows the shareholder a credit for the company tax that has already been paid. If the receiving shareholder is on a marginal tax rate that is higher than the corporate rate (of 28%), a shareholder receiving a fully imputed dividend will pay a top-up of tax to their marginal rate (for example, 11% of the grossed-up dividend or approximately 15% of the cash dividend for a shareholder with a 39% tax rate receiving a fully imputed dividend).

2.7 Example 1 provides a simple example of an imputed dividend paid by a company to a shareholder.

Example 1: Payment of a dividend

Bill is the sole shareholder in C Co and is on the top personal income tax rate of 39%.

In 2025, C Co made a taxable profit of $1 million and paid tax on that amount at the corporate tax rate of 28%. C Co therefore has retained earnings of $720,000 and $280,000 imputation credits.

Bill is buying a new home and wants to use the profit of C Co in his personal capacity to fund a portion of the purchase.

In 2026, C Co resolves to distribute the 2025 profit and pays Bill a fully imputed $1 million dividend (cash of $720,000 and imputation credits of $280,000). Bill's tax liability on the dividend is $390,000, which means he has to pay top-up tax of $110,000. This gives Bill $610,000 after tax to put towards the house purchase.

The top-up tax of $110,000 is equal to 11% of the total dividend amount ($1 million), and 15.28% of the cash dividend ($720,000). This top-up tax will be satisfied, in part, by the company withholding resident withholding tax.

2.8 If no imputation credits are attached to the dividend, the shareholder will be required to pay tax on the full amount at their marginal tax rate, with the tax liability funded, in part, by the company withholding resident withholding tax. This may be the case if, for example, the dividend is funded from a capital gain or a foreign sourced amount because there may have been no New Zealand tax paid by the company on those amounts.

2.9 The broad definition of dividend for tax purposes means that a dividend can arise even when there has been no formal declaration of a dividend or requirement for the solvency test to be met under company law. The current law also contains a number of specific inclusions within the scope of a dividend. For example, a dividend will arise when property of a company is made available to a shareholder for less than market value (including a low interest loan).

2.10 There are also a number of exceptions to the treatment of a transfer of value from a company to a shareholder as a taxable dividend. Two of these exceptions relate to the return of capital on a share cancellation or liquidation and are discussed further below.

Return of debt or equity investment

2.11 A shareholder can make an investment in a company in two main ways, by subscribing for shares or by making a loan to the company. In most cases, a return of those amounts to the shareholder is not taxable.

2.12 The repayment of a debt owed by a company to a shareholder (other than interest) is tax free to the shareholder (in the same way as it is tax free to any other lender). Whether a payment in relation to debt is treated as interest (taxable to the lender) or a repayment of principal depends on the financial arrangements rules in subpart EW of the Income Tax Act 2007, which generally apply economic principles.

2.13 A company can pay to purchase, redeem or otherwise cancel its own shares, according to their terms or otherwise. These payments will be excluded from being dividends if they satisfy certain legislative requirements (generally relating to relative size or effect on ownership), to the extent that it represents a return of ASC. In general terms, ASC is the amount paid by a shareholder to subscribe for shares in the company. If the legislative requirements are not met, the amount paid by the company for the shares will be a dividend.

Payment for goods or services (including shareholder remuneration)

2.14 Frequently, a shareholder in a close company is also an employee working for the company and entitled to remuneration. In these cases, the company makes a payment to the shareholder for the services provided (usually director’s fees, salary or wages). These amounts are not a dividend. The amount is income to the shareholder as remuneration. Unlike a dividend, the amount is deductible to the company.

2.15 Generally, a salary can only be paid to persons providing services to the company. The Companies Act also places some constraints on the amount that can be paid for services to directors – it should be fair, and it is possible that some regard should be had to the solvency of the company.

2.16 In some situations, a company will pay a shareholder for other goods or services provided to the company by the shareholder. If the amount paid by the company is an appropriate amount, then the amount will not be a dividend to the shareholder. When there is an overpayment by a company for goods and services provided by a shareholder that is caused by the shareholding, it is a dividend.

Shareholder loans

2.17 Another way that a company can provide funds to a shareholder is by way of a shareholder loan. This is a well-established commercial mechanism that is especially common in close companies where the shareholder controls the company or between companies that are 100% commonly owned.

2.18 Although all shareholder loans result in a debt owed by the shareholder to the company, there can be a significant difference in the degree of formality with which they are brought into existence.

2.19 At one end of the spectrum, the company and the shareholder may enter into a formal loan agreement, with specific terms relating to repayment and the applicable interest rate. This might occur when, for example, the company has excess funds that it does not need in the short term, or if the company has funds that arose from the sale of a capital asset. Formal loans are more likely if the company has more than one unrelated shareholder, because the company needs to ensure that all shareholders are treated fairly.

2.20 At the other end of the spectrum, a shareholder may have access to a company bank account or credit card and use the available funds in that account for private purposes. This type of situation will be more common when the company only has one shareholder or a small number of related shareholders. The amount is treated as a debit to a shareholder current account and, when the current account is overdrawn, there may be no agreement about terms of repayment or interest. It is common practice for the annual shareholder salary to be credited to this current account, which would reduce the amount owing.

2.21 From a company law perspective, making a loan to a shareholder does not require consideration of the company's continued solvency once the loan is made because it does not legally reduce the company's assets. Of course, if the shareholder is unable to repay the loan, that may eventually affect the company's solvency.

2.22 Under current tax law, money received as a loan (the principal amount) is not a dividend because of the legal obligation to repay the money. This means that in most situations the amount loaned to the shareholder will not be taxable income for the borrower and is not deductible to the lender.

2.23 A shareholder loan will generally only result in taxable income for the shareholder in two situations:

- interest on the loan is charged at less than a prescribed interest rate, to the extent of the difference, or
- repayment is not required, for example, if the loan is forgiven or becomes unrecoverable.

Prescribed rate of interest

2.24 A dividend arises when the company charges the shareholder less than a prescribed rate of interest on the loan, to the extent that the interest charged by the company is less than the prescribed rate. The amount of the loan itself is not a dividend under these rules. The dividend is calculated quarterly, for each quarter when the loan is outstanding, and is treated as being paid to the shareholder six months after the end of the company's income year.[3]

[3] Under section CD 39(3) of the Income Tax Act 2007, unless the company gives notice of an earlier date.

2.25 It is not necessary for the shareholder to actually pay interest to the company to prevent a dividend arising. No dividend will arise provided interest accrues on the loan at the prescribed rate or a higher interest rate. Inland Revenue does not have any data on how many shareholder loans have interest accruing compared to those where interest is paid.

2.26 If the shareholder is also an employee of the company, fringe benefit tax (FBT) will apply rather than dividend treatment. FBT also uses the prescribed rate to calculate the amount of the benefit.

2.27 These rules are intended to ensure that when a company lends money to a shareholder, it cannot transfer value to the shareholder by charging a discounted rate of interest. It is the benefit to the shareholder of using the money that is a dividend under the current rules, not the principal amount of the loan itself. The dividend that arises will be significantly less than would have been the case if the company had paid a dividend to the shareholder of the loan amount.

2.28 The prescribed rate of interest is based on the Reserve Bank's first home floating mortgage rate. The rate is currently 6.67% per annum (effective since 1 July 2025).

2.29 Examples 2 and 3 demonstrate the impact of the prescribed rate.

Example 2: Prescribed rate of interest

C Co from Example 1 has been exploring an option to acquire a new business asset and decides that the time is not right to pay Bill a dividend. Bill still wants to use the funds to help him purchase his new home. Bill is not an employee of the company, so FBT will not apply.

C Co decides that instead of paying Bill an immediate dividend, it will lend Bill $720,000 on an interest-free, repayable on demand basis. The loan is made on 1 April 2026. C Co has a standard balance date.

Because the loan is interest free, Bill is treated as having been paid a dividend equal to the prescribed rate of interest for each quarter that the loan is outstanding. The amount of the dividend is treated as being paid six months after the end of the company's income year.

At the current prescribed rate of 6.67%, Bill will be deemed to have been paid a dividend of $48,024 (being the sum of the four quarterly dividends) on 30 September 2027 (being six months after the end of C Co's income year).

At Bill's marginal tax rate of 39%, he will have tax to pay on the deemed dividend of $18,729.36. Bill will be allowed a credit against this tax liability for any imputation credit attached to the dividend by C Co. If the prescribed rate remains unchanged, an equivalent dividend will arise to Bill in each year that the loan remains outstanding. Six years from when the first deemed dividend arises, total tax on the deemed dividends (assuming no change to the prescribed rate) will be $112,376.16. This is similar to the amount of tax Bill would have had to pay if C Co had paid the amount to him as a dividend rather than as a loan.

Example 3: Interest charged on loan at prescribed rate

Towards the end of 2026, C Co resolves to formally document the loan to Bill and start charging quarterly interest at the prescribed rate.

Bill will no longer be deemed to receive a dividend. C Co will have income each year of $48,024, on which tax of $13.446.72 will be payable (at the corporate rate of 28%).

This will be the case even if the interest is capitalised to the loan and not paid by Bill in cash.

Non-repayment of loan

2.30 The amount of a shareholder loan (both principal and any accrued interest) will be income for the shareholder under either the dividend rules or the financial arrangements rules if the loan is not required to be repaid.

2.31 If the loan is forgiven by the company (that is, the company releases the shareholder from the obligation to repay the loan) because of the shareholding relationship, the amount forgiven will be treated as a dividend derived by the shareholder. This will likely be the case in most situations when close companies forgive loans to their shareholders. The dividend will be taxed at the marginal tax rate of the shareholder.

2.32 Example 4 shows the consequences of a loan being forgiven by the company due to the shareholding relationship.

Example 4: Loan forgiveness

After a few years, C Co decides that it no longer has any need for the funds that it loaned to Bill in Example 1. Rather than declaring a dividend that Bill can use to repay the loan, C Co simply releases Bill from his obligation to repay the debt.

C Co has forgiven the loan to Bill due to his shareholding in the company, so the amount will be a dividend to Bill. If the dividend is unimputed, Bill will have to pay tax of $280,800 on the dividend (being tax on $720,000 at his marginal tax rate tax of 39%). If the company attaches imputation credits to the dividend, they will provide Bill with a credit of tax.

2.33 If the shareholder loan is forgiven by the company for any reason other than the shareholding relationship, the amount will be income to the shareholder under the financial arrangements rules (and will generally be non-deductible to the company). The effect of this is that the amount of the loan will be subject to tax at the marginal tax rate of the shareholder at the time of forgiveness.

2.34 The financial arrangements rules will also apply to treat a shareholder loan (principal and accrued interest) as income for the shareholder in other situations. For example, if the shareholder is never required to repay the loan, income will arise under the financial arrangements rules when the loan becomes unenforceable due to the lapse of time. This rule is not well understood and can be difficult to apply in practice.

2.35 One situation with particular uncertainty about the application of this rule is when a shareholder loan has not been repaid at the time the company is removed from the Companies Register. There are many reasons why a company could be removed from the Companies Register, ranging from a formal liquidation through to non-compliance with the reporting requirements of the Companies Act. As discussed in more detail in Chapter 3, many companies have outstanding shareholder loans when they are removed from the Companies Register.

2.36 The mere removal of a company from the Companies Register does not result in income under the financial arrangements rules because the loan is not terminated, it becomes the property of the Crown. The loan eventually ceases to exist when it becomes unenforceable under the Limitation Act 2010. Once the loan becomes unenforceable, the shareholder will have income under the financial arrangements rules. The exact timing of this is often unclear, but it can be six or fifteen years after the money was borrowed, or three years after the company was struck off depending on the particular facts.

2.37 Due to there not being a clear date that income arises and a lack of comprehensive data, it can be difficult for Inland Revenue to monitor and assess whether a shareholder has complied with this rule. Inland Revenue is currently working to enhance its processes for companies that are closing down. This will improve Inland Revenue’s ability to support companies and shareholders to ensure their tax obligations are fully understood and completed before a company is removed from the Companies Register. This will include working with the Ministry of Business, Innovation and Employment to share information. These enhancements will complement the proposals in this issues paper and improve our ability to effectively enforce the law.

2.38 Example 5 highlights the issues with loans that become unenforceable after a company is removed from the Companies Register.

Example 5: Loan becomes unenforceable

Paul is the sole director of and shareholder in A Co. He regularly uses money in the company’s bank account to pay personal expenses. He and his accountant keep track of this through a shareholder’s current account with the company. After the end of each year, Paul’s accountant calculates the company’s income and allocates that amount to Paul as salary, which is set off against the drawings. However, the result for the last two years is still a net current account liability of Paul to the company (that is, the shareholder current account is overdrawn).

Paul has a difficult couple of years, and A Co fails. A Co fails to file its annual return with the Companies Office. The Companies Office takes the necessary steps to remove A Co from the register of companies. This means A Co ceases to exist and cannot enforce the repayment of any debts owed to it. A Co does not forgive the loan, so the loan vests in the Crown.

It is not entirely clear when the debt becomes unenforceable through lapse of time under the Limitation Act. When it does, income will arise for Paul under the financial arrangements rules. However, Paul is unaware of this rule and by the time that income arises, many years have passed and Paul has moved on to a new venture.

Consequences of loan repayments

2.39 There will generally be no tax consequences for the company or the shareholder when a loan is repaid by the shareholder, unless those consequences arise from the way the shareholder obtains the funds to repay the loan.

2.40 One common way for short-term loans to be repaid is for the company to declare a dividend of the amount of the loan (grossed up to the shareholder's marginal tax rate), which the shareholder will use to repay the loan. In that situation, the dividend will be taxable income for the shareholder.

2.41 It is also common practice for short-term loans to be repaid through application of a shareholder salary. Many small companies pay out most or all of their profit each year as a salary to one or more shareholder–employees. The salary is taxable income to the shareholder. Tax law allows a shareholder salary that is declared up to 12 months after year end to be applied to loans made from the start of the year, provided the salary is deductible to the company in that year.

2.42 Example 6 shows a shareholder being paid a dividend and using that amount to repay a shareholder loan.

Example 6: Using dividend to repay loan

Following on from Example 2, rather than formally documenting the $720,000 loan in 2027, C Co decides to pay Bill a fully imputed dividend so that he can repay the loan.

The loan is made on 1 April 2026, and the dividend is paid to Bill in June 2027. C Co has a standard balance date.

Because the loan was interest free, as with Example 2, Bill will be treated as receiving a deemed dividend of $48,024 on 30 September 2027 on which he will have to pay $18,729.36 tax.

The amount of the dividend C Co resolves to pay Bill is $1,185,000 (cash of $853,200 and imputation credits of $331,800). Bill's tax liability on the dividend is $462,150, which means he has to pay top-up tax of $130,350. This leaves Bill $722,850 after tax to repay the loan.

This example results in Bill having more tax to pay overall, but the tax liability on the principal amount (net of imputation credits) has effectively been deferred for a year.

2.43 Another way that a shareholder might obtain the funds to repay a shareholder loan, especially for larger loans, is by selling some or all of the shares in the company. In the absence of any integrity concerns, the amount received from the sale of shares will usually be treated as a capital receipt.

2.44 Example 7 shows a shareholder loan being repaid from the proceeds of a sale of shares in the company.

Example 7: Using proceeds from sale of shares to repay loan

Following on from Example 4, C Co has been charging interest on the loan, with the interest capitalised. In 2030, Bill sells the company to an unrelated purchaser for a significant capital gain. Bill uses the proceeds from the sale to repay the full loan balance to C Co. Assuming no other features exist that raise integrity concerns, Bill will have no tax to pay on the sale proceeds.

Liquidation

2.45 Under company law, liquidation is a process by which a company is brought to an end. A liquidator is appointed to take control of the company's assets, sell them, and use the proceeds to pay off creditors. Any remaining funds are then distributed to shareholders.

2.46 In recent years, approximately 10% of companies that have ceased to exist have done so through a liquidation.

2.47 For tax purposes, liquidation is broader than the company law concept. In the Income Tax Act, liquidation does not require the appointment of a liquidator because the term includes any situation when a company is removed from the Companies Register.

2.48 Under tax law, any distributions paid on liquidation of a company are not taxable as a dividend to the extent they are returns of ASC and ACDA. ASC is generally the same as the amount paid by a shareholder to subscribe for shares in the company. A company's ACDA is its net capital gains (that is, gross capital gains less gross capital losses if positive), plus any net capital gains distributed to it on liquidation of other companies.

Determining ASC and ACDA on liquidation

2.49 The calculation of ASC and ACDA is not straightforward.[4] Although the core definitions are simple enough, complexities arise because of the tax treatment of different transactions that need to be taken into account.

2.50 In relation to both ASC and ACDA, many years may pass between the occurrence of the transactions giving rise to positive or negative entries, and the time when a distribution is made. ASC and ACDA are often only relevant if and when a company liquidates with surplus funds. The calculation of ASC and ACDA can be extremely difficult, as it requires a careful record of both the law and transactions going back to the formation of the company. This period will often be longer than the required seven-year record retention period.

2.51 There are no explicit requirements for a company to keep records for, or to report ASC or ACDA amounts to Inland Revenue, which means it is difficult for Inland Revenue to verify amounts. Despite this, as set out in Inland Revenue's operational statement OS 22/01,[5] a company that does not have records to substantiate its ASC and ACDA is at risk of losing the benefit of those amounts because it will not be able to satisfy the burden of proof required to take a position that some or all of a distribution is not a dividend.

Summary

2.52 The current tax rules provide for different outcomes for shareholder loans compared with other ways of providing funds to a shareholder, such as dividends or salary. In summary, the different ways in which funds can be provided from a company to a shareholder have the following tax treatments:

- Dividends are taxed at the marginal tax rate of the shareholder, with a credit for any imputation credits attached.
- Returns of equity or debt capital will be a non-taxable capital receipt in most cases because they simply represent a repayment of the amount invested by the shareholder.
- Payments for goods or services can give rise to a dividend if they are not at market value. Shareholder remuneration will always be taxable to the shareholder.
- Shareholder loans will generally only result in tax for the shareholder to the extent that interest on the loan is less than a prescribed interest rate, or if repayment is not required.
- Amounts paid on liquidation of the company will be a dividend to the extent they exceed the company's ASC and ACDA. There are currently no record-keeping or reporting requirements for ASC or ACDA.

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[4] The rules also change from time to time, meaning that the appropriate treatment of a transaction depends on the year in which it takes place.

[5] Available Subscribed Capital record-keeping requirements

2.53 We note that there may be cases when it is appropriate for Inland Revenue to use the general anti-avoidance rule to challenge structures that deliberately take advantage of the current rules. However, our concerns with the current law and the proposals in this issues paper are not limited to situations when the general anti-avoidance provision could apply.

Questions for submitters

Q1. Do you think this is an accurate summary of the current law? Do you think there are any other rules that are relevant?

Q2. Are there other reasons why shareholders take drawings or loans from their companies?

Q3. Do you think New Zealand's current laws for taxing company payments to their shareholders are well understood and complied with?

Q4. In your experience, do companies maintain reliable records of their ASC and ACDA? If not, why not?

Chapter 3 – Inland Revenue data on shareholder loans

3.1 Inland Revenue's data on shareholder loans is self-reported data from the IR4, IR4S and IR10. The accuracy of this data depends on the forms being correctly completed by taxpayers with full and complete disclosure of the relevant loans. For this reason, Inland Revenue data may not present a completely accurate picture of the stock of shareholder loans. However, we consider that the data is useful in highlighting general trends and demonstrating why we have concerns about the current law.

3.2 This chapter looks at the data on shareholder loans made to shareholders of close companies who are natural persons or trustees, focusing on two specific aspects:

- the stock of shareholder loans, and
- the existence of shareholder loans when companies are removed from the Companies Register.

Stock of shareholder loans

3.3 For the income year ended 31 March 2024, Inland Revenue data records that approximately 119,000 companies (about 16% of the 730,000 total companies in New Zealand)[6] were owed a total of nearly $29 billion by about 165,000 shareholders who were natural persons or trustees. For context, these companies reported $8 billion of taxable income in that same period, so the loan balances were over 3.5 times their annual income.

3.4 The average amount loaned by these companies to these shareholders was over $245,000 per company, or over $177,000 per shareholder. The average number of shareholders with a loan for each lending company was 1.4 shareholders.

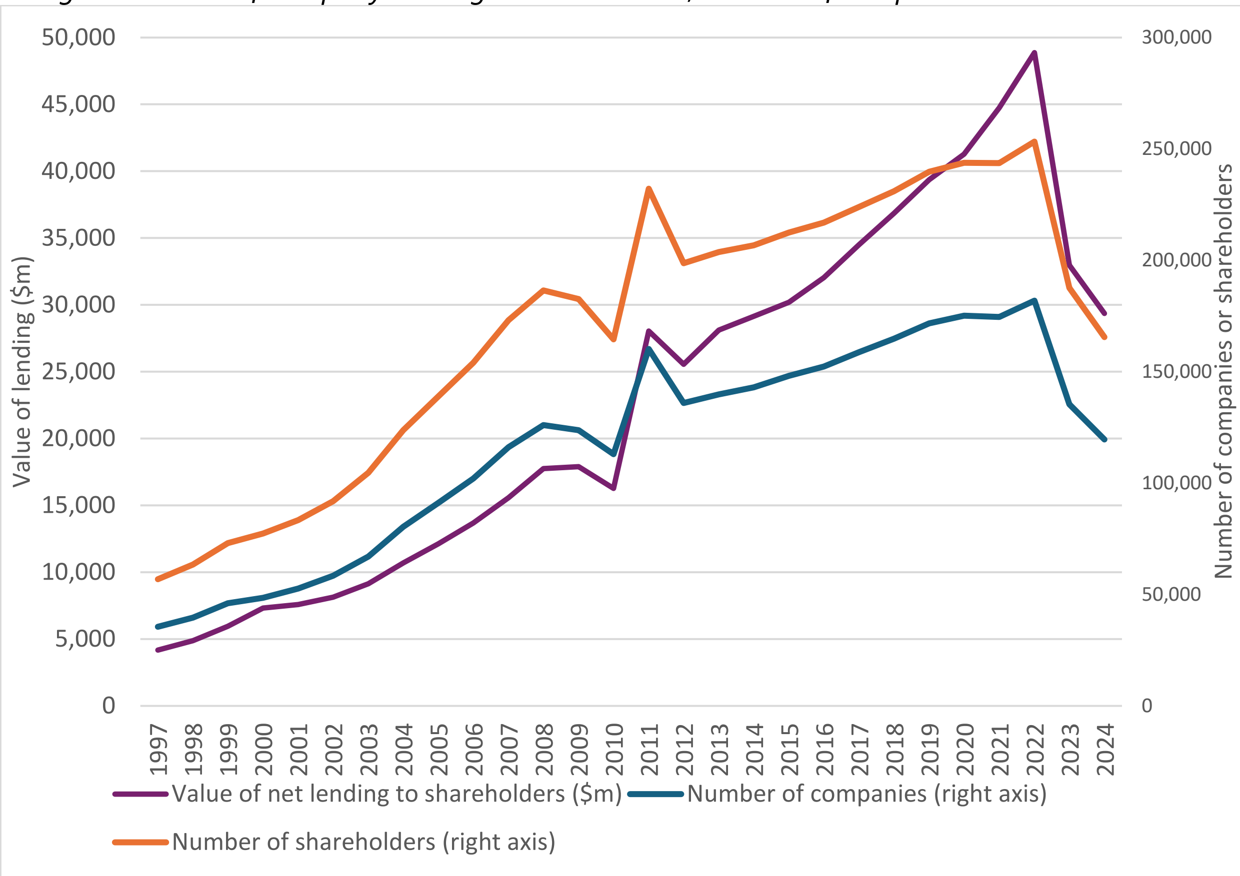
3.5 Figure 1 below shows that the amount of shareholder loans made to natural persons and trustees peaked in 2021 to 2022 when about 182,000 companies recorded loans totalling $48.8 billion owed by about 253,000 shareholders who are natural persons or trustees (an average of around $269,000 per company or about $193,000 per shareholder). There was also a peak in the 2011 income year, which is likely due to the changes in tax rates announced in Budget 2010.

3.6 Some of the reduction in company loans to shareholders between 2022 and 2024 may reflect the fact there were large increases in dividend payments to shareholders who were trustees ahead of the trustee tax rate being increased to 39% from 1 April 2024. Company profits of the affected companies were also high during this period, which may have led to more dividends being declared and used to repay earlier loans. It is also possible that there was an increase in companies with shareholder loans being removed from the Companies

[6] Note, this includes all companies registered with the Companies Office in 2024, not just close companies. The proportion of close companies with shareholder loans will be higher than this.

Register. We are interested in any other explanations submitters may have for this reduction.

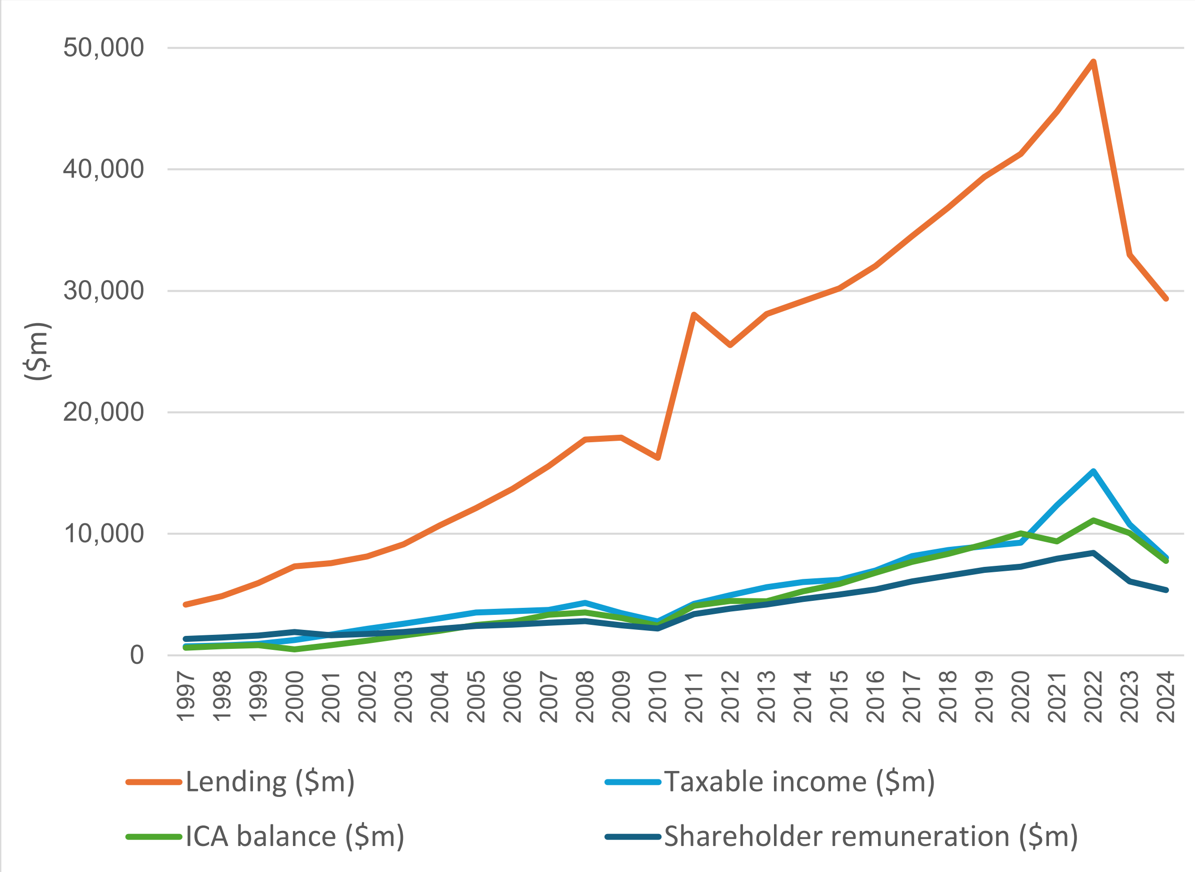
Figure 1: Value of company lending to shareholders, number of companies and shareholders



3.7 Annual growth in loans to shareholders has been approximately 8.7% per annum over the period 1997 to 2023, surpassing the average growth in economic activity over the same time period (nominal GDP average annual growth 5.4%).

3.8 Figure 2 below shows how lending by companies to shareholders has grown relative to taxable corporate income, imputation credit account (ICA) balances and shareholder renumeration. The ratio between lending to shareholders, corporate taxable income, and ICA balances has remained relatively constant over the period being examined. A growth in ICA balances would suggest that profits are being retained in the company, or provided to shareholders by way of loans, rather than being distributed as imputed dividends.

Figure 2: Lending to shareholders, taxable income, imputation credit account balances and shareholder remuneration of lending company



3.9 Inland Revenue data shows an overall trend of an increase in outstanding shareholder loan balances over time that appears to reflect changes in personal tax rates.

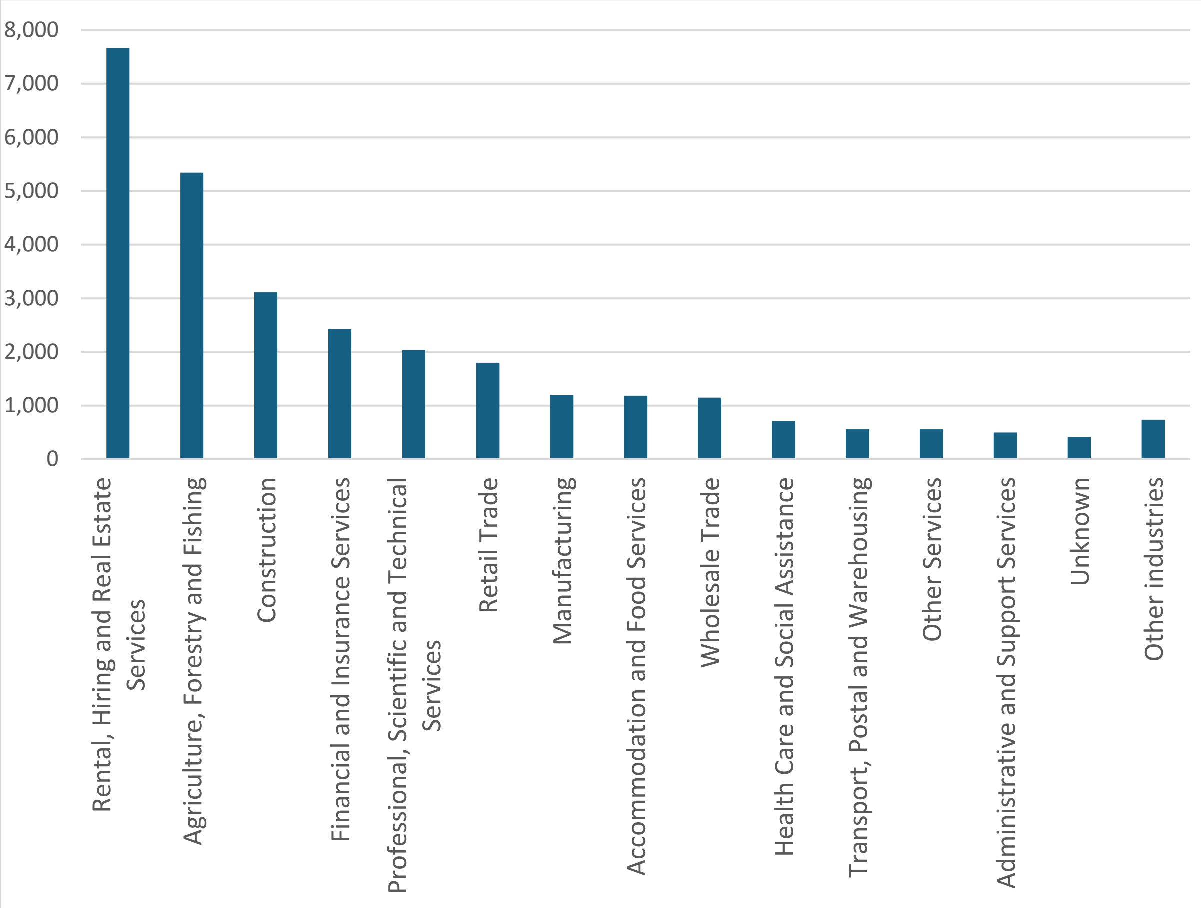
3.10 Inland Revenue data also shows that there are a small number of very large loans.

3.11 While 50% of all companies with shareholder loans in 2024 had outstanding loan balances of less than $50,000, a small number of companies had made very large loans, which represented a high proportion of the total value of shareholder loans:

- Approximately 5,500 companies had outstanding loan balances of more than $1 million (55% of the total value of all loans compared to being about 5% of all companies with shareholder loans).
- Approximately 540 companies had outstanding loan balances of more than $5 million (22% of the value of all loans compared to being about 0.5% of all companies with shareholder loans).

3.12 The main industries with outstanding shareholder loans were rental, hiring and real estate services (26% of the total value of loans), agriculture, forestry and fishing (18%), and construction (11%), as shown in Figure 3 below.

Figure 3: Value of outstanding shareholder loans ($m) by industry, 2024



Existence of shareholder loans when companies removed from Companies Register

3.13 Based on data from the Companies Office, over the nearly six-year period from 1 April 2019 to early 2025, approximately 225,000 companies were removed from the Companies Register. It is possible that some of these companies may have been reinstated to the Companies Register, but we do not have data on those companies.

3.14 Of the approximately 200,000 of these companies that Inland Revenue has data for, 16,000 are look-through companies, so are not relevant to the analysis. We have analysed the self-reported tax return data of the remaining 184,000 companies.

3.15 Our data suggests that about 27,000 of these companies (nearly 15%) were owed money by their shareholders at the time they were removed. In aggregate, those companies were owed a total of $2.28 billion by shareholders who were natural persons or trustees in their last filed company shareholder return prior to being removed from the Register.

3.16 The average amount of outstanding loans per company was nearly $85,000. More specifically, our analysis shows:

- Approximately 123,000 companies were removed on the motion of the Registrar for non-compliance with requirements of the Companies Act 1993, generally because they failed to file an annual return. Of those, approximately 15,000 had outstanding shareholder loans, with a total of $935 million owed by shareholders who were natural persons or trustees. On a per company basis this is $55,000.
- Approximately 49,000 were removed at the request of the shareholders. Of those companies, approximately 10,000 were owed amounts by their natural person or trustee shareholders, totalling $923 million. On a per company basis this is $92,300.
- Approximately 10,000 were removed following a formal liquidation process. Of those companies, approximately 2,000 showed shareholder loans, totalling $426 million. On a per company basis this is $213,000 per company.

3.17 Outstanding shareholder loans are frequently a feature of public reporting on company liquidations, giving the perception that shareholder loans are associated with company failure and consequent loss to Inland Revenue and other creditors. The existence of shareholder loans can be a reason why a company is unable to pay its creditors or Inland Revenue when the company is liquidated.

Questions for submitters

Q5. Are you aware of any reason for the reduction in shareholder loans in 2024, other than the change in the trustee tax rate?

Q6. Does the data on the use of drawings and other loans to shareholders reflect your observations or experience?

Q7. Do you agree that shareholder loans are often linked with company failure?

Chapter 4 – Summary of problem

4.1 Shareholders in close companies will often borrow from their company to manage cashflow and fund private expenses or other unrelated business activities. Many of these loans will not be formally documented. Given the close relationship between the shareholder and the company, shareholder loans are often made on very informal and borrower-friendly terms.

4.2 As a general principle, the broad definition of dividend for tax purposes means that any permanent transfer of value by a company to a shareholder should be income to the shareholder, taxed at the shareholder's marginal tax rate.

4.3 The current treatment of shareholder loans can undermine this general principle and give a tax advantage to the shareholder. Because of the legal obligation to repay the money, shareholder loans are not generally treated as a dividend or another type of income for the shareholder, even though the shareholder has the use of the company's funds. In many cases, the tax advantage from shareholder loans will be temporary because the loan will be repaid. However, the tax advantage can become permanent if the loan is never repaid.

4.4 Shareholder loans are often associated with company failure and can be a factor in why a company is unable to pay its creditors or Inland Revenue when the company is liquidated. This is consistent with the data discussed in Chapter 3.

4.5 The current treatment of shareholder loans can provide an unintended tax advantage for close companies that is not available to other types of businesses. Businesses operated by sole traders, partnerships or look-through companies are immediately taxed at their owner's marginal tax rate (typically 33% or 39%) when the business earns income. In contrast, when a shareholder receives funds from their company in the form of a loan, the company will often only be required to pay a small amount of tax on the loan interest each year (at the 28% company tax rate, and the interest can be capitalised into the outstanding loan balance).

4.6 Widely-held companies will not typically distribute their profits by way of loan. Instead, when they decide to distribute their profits to shareholders, widely-held companies will declare dividends that are taxed at the shareholder's marginal tax rate.

4.7 Our specific concerns with the current law relating to shareholder loans are described below.

Current law can provide unintended tax advantage when companies lend funds to shareholders

4.8 As discussed in more detail in Chapter 2, in practice, our current rules mean that a shareholder loan will only result in taxable income for the shareholder in two situations:

- interest charged on the loan is less than a prescribed interest rate, to the extent of the difference, or

- repayment is not required, for example, if the loan is forgiven.

4.9 In contrast, the full value of a dividend will be taxed immediately (with a tax credit for any attached imputation credits) at the marginal tax rate of the shareholder. Even taking into account the prescribed interest rate, the effect of this is that there seems to be an unintended tax advantage when companies lend funds to shareholders, compared with paying dividends. While there is a legal obligation on a shareholder to repay the loan, shareholder loans can be used to provide funds to a shareholder for a long time.

4.10 This results in the current rules being unfair to shareholders who receive dividends or salaries, partners, sole traders and employees, who will typically be taxed at a higher marginal tax rate (33% or 39%) at the time they receive the income.

Current tax rules provide little incentive to repay loans

4.11 The current tax rules provide little incentive for shareholders to repay loans they owe to their companies.

4.12 A small amount of tax is collected (often at the 28% company tax rate) as interest income gradually accrues on the loan.

4.13 There is no requirement that the loan be repaid within a certain period of time or before the company goes out of existence. Therefore, large loan balances can remain owing indefinitely.

4.14 Inland Revenue data shows the existence of a large number of shareholder loans. A small number of those loans are very large and represent a high proportion of the total value of outstanding shareholder loan balances. Approximately 5,500 companies had outstanding loan balances of more than $1 million (55% of the total value of all loans compared to being about 5% of all companies with shareholder loans), and approximately 540 companies had outstanding loan balances of more than $5 million (22% of the value of all loans compared to being about 0.5% of all companies with shareholder loans).

4.15 In Chapter 6, we discuss a proposal to treat certain shareholder loans that exceed a de minimis threshold as dividends if the loan is not repaid within a set period of time. This proposed measure could encourage repayment of shareholder loans and is intended to limit or reduce the incentive to use shareholder loans rather than paying dividends.

Tax not paid on shareholder loans when company removed from Companies Register

4.16 The existence of shareholder loans can be a reason why a company is unable to pay its creditors or Inland Revenue when the company is liquidated. While a liquidator will attempt to recover any shareholder loans to repay creditors, we understand this can be difficult due to a lack of records or the limited ability of the shareholder to repay. Media reporting on company failures gives a strong perception that shareholder loans are associated with company failure and consequent loss to creditors. This perception is reinforced by the Inland Revenue data discussed in Chapter 3.

4.17 Under current law, if a loan is forgiven by a company or a loan becomes unenforceable, income will arise for the shareholder (either a dividend or under the financial arrangements rules). However, there is uncertainty about when this income arises for a shareholder of a company that is removed from the Companies Register, which makes it difficult for Inland Revenue to monitor and assess whether a shareholder has complied with their obligations.

4.18 Based on our analysis of nearly six years of data from the Companies Office, nearly 15% of all companies that were removed from the Companies Register had outstanding shareholder loans. In aggregate, those companies were owed a total of $2.28 billion by shareholders who were natural persons or trustees in their last filed company shareholder return prior to removal from the Companies Register.

4.19 In Chapter 7, we propose a rule that would treat any outstanding shareholder loan amount as income to the shareholder at the time that the company is removed from the Companies Register. This proposal is expected to support the ongoing improvements to Inland Revenue's processes and systems discussed briefly in Chapter 2 by removing the uncertainty around when income arises for the shareholder.

Current reporting and record-keeping requirements do not support compliance

4.20 The rules concerning reporting and record keeping (both in relation to shareholder loans and available subscribed capital or available capital distribution amounts) do not support the correct and timely calculation of tax for shareholders of companies in liquidation.

4.21 In this issues paper, we propose various reporting and record-keeping measures that are aimed at supporting compliance by taxpayers and effective review by Inland Revenue.

Questions for submitters

Q8. Do you agree the current tax rules provide an unintended tax advantage when companies lend funds to shareholders compared with paying taxable dividends?

Q9. Do you agree that the taxation of shareholder loans can be improved?

Q10. Do you have any other comments about the problem?

Chapter 5 – International treatment of shareholder loans

5.1 In 2024, the OECD released a working paper titled *Tax arbitrage through closely held businesses: Implications for OECD tax systems.*[7] The paper highlights how closely held businesses can be used to shift or defer taxable income. One key area of concern is loans from companies to their shareholders. The paper recommends that countries implement strict rules and monitoring to ensure these transactions are genuine loans rather than disguised distributions of income. Some countries address this risk by reclassifying unrepaid shareholder loans as taxable dividends under certain circumstances.

5.2 The New Zealand treatment of shareholder loans is out of step with the recommendations of the OECD working paper. Inland Revenue is concerned that New Zealand's current rules relating to shareholder loans are less effective than rules in other comparable jurisdictions. Other jurisdictions have specific rules to encourage repayment of loans made to shareholders.

5.3 In this chapter we summarise the treatment of shareholder loans in other jurisdictions that have specific rules for treating shareholder loans as dividends. This is intended as a summary only and is not a comprehensive review of the rules that apply in any of those jurisdictions.

Australia

5.4 In Australia, the general rule is that a loan by a private company to a shareholder or associate is taxed as an unfranked (unimputed) dividend at the shareholder's marginal tax rate in the year it is made if it has not been repaid by the due date for the company's tax return for that year (generally 10 months).

5.5 The Australian legislation has a number of broad exceptions to the general rule. The loan will not be treated as a dividend in the following circumstances:

- If it was not made out of "distributable surplus". "Distributable surplus" is broadly equivalent to a company's retained earnings, but the precise definition is considerably more complex. It is common for the retained earnings figure in a company's balance sheet to be different from the distributable surplus amount.
- If it is subject to a complying loan agreement. To comply there must be a written agreement in place before the company's tax return is due for the income year in which the loan amount was paid to the shareholder or their associate. This agreement must include the parties to the loan, the amount and term of the loan, the interest rate (the minimum complying interest rate is benchmarked to variable mortgage rates for an

[7] Zawisza, T. et al. (2024), "Tax arbitrage through closely held businesses: Implications for OECD tax systems", OECD Taxation Working Papers, No. 70, OECD Publishing, Paris, para 71, https://doi.org/10.1787/24b4ed4d-en

owner-occupied home), and annual repayments for the loan (based on the maximum term being seven years if unsecured or 25 years if secured against real property).

- If it is made in the ordinary course of business and on the usual terms the private company applies to similar loans to entities at arm's length.
- If it is used to purchase shares under an employee share scheme.
- If it was made before 4 December 1997 (the date of enactment), if there has been no variation of the terms or amounts since it was made.

5.6 If a taxpayer has made an honest mistake or inadvertent omission that led to a loan being treated as a deemed dividend, the Commissioner of Taxation has a discretion to disregard the deemed dividend or allow franking credits to be attached. Among other factors, the Commissioner will consider whether the taxpayer has taken corrective action to address the mistake or omission and comply with the rules.

5.7 If a loan that has previously been treated as a dividend is repaid, the tax paid by the shareholder will not be refunded.

5.8 The Australian legislation contains specific anti-avoidance measures that disregard a loan repayment if a reasonable person would conclude that when the repayment was made, it was intended that another loan would be made by the company for a similar or larger amount.

United Kingdom

5.9 In the United Kingdom (UK), a loan made from a close company to a shareholder or associate will be taxed at 33.75% if it has not been repaid within nine months following the end of the accounting period in which it was made. This tax is payable by the company, not by the shareholder that received the loan.

5.10 The UK rules have been described as an anti-avoidance measure that is intended to deter participators (that is, shareholders) from permanently extracting value from close companies without that value being charged as taxable remuneration or dividends.

5.11 The UK rule is broad, with only two narrow exceptions:

- a loan made in the ordinary course of a business carried on by a company, if the business includes lending money, and
- loans made to a trustee of a charitable trust if it is for charitable purposes only.

5.12 The UK has no exceptions for loans that are subject to market interest rates. All loans must be repaid within the nine-month timeframe to avoid triggering the tax. Interest should still be charged on all loans at the HMRC rate because any discounted interest rate will be classified as a benefit in kind and subject to tax.

5.13 The UK also has a de minimis threshold of £15,000 (approximately NZ$34,000) for loans to a director or other employee, which means that any loan below that amount will not be taxed.

5.14 If the loan is subsequently repaid by the shareholder, the tax will be refunded to the company when the tax return covering the year of repayment is filed (which is nine months after the accounting year in which the loan was repaid). Any claim for a tax refund following repayment must be made within four years from the end of the financial year in which the loan was repaid.

5.15 The UK has a specific anti "bed and breakfasting rule", which prevents loans being temporarily repaid or partially repaid and drawn down again within 30 days. In such cases, the repaid amounts would not generate any relief from tax and would be ignored for the purposes of the nine-month period.

Canada

5.16 In Canada, a loan made from a connected corporation to a shareholder or associate will be taxed at the shareholder's marginal rate unless it has been repaid within one year from the end of the taxation year of the company.

5.17 The Canadian legislation has limited exceptions for:

- loans made for specific purposes (for example, to purchase a motor vehicle for business purposes, a principal place of residence for the shareholder, or shares in the company), and
- loans made in the ordinary course of a lending business on arm's length terms.

5.18 Even if a loan meets one of these exceptions, the loan must carry an interest rate that is equal to or greater than Canada's prescribed rate or the shareholder will need to account for a deemed interest benefit in their tax return. The Canadian legislation does not have a de minimis threshold – all unrepaid loans are subject to tax for the shareholder.

5.19 When the loan is repaid, the shareholder will receive a deduction for any repayment amount in the year that the repayment is made.

5.20 The Canadian legislation contains specific anti-avoidance rules to prevent a long-term loan from being disguised by a series of short-term loans and repayments.

Norway

5.21 In Norway, a loan made from a private limited company to a shareholder or associate will be taxed as a dividend for the shareholder, unless it has been repaid within 60 days. This means a loan is subject to tax unless it is repaid almost immediately.

5.22 There are some exceptions from the tax for:

- loans taken out before 7 October 2015 (the date of enactment of the rules)
- loans in the ordinary course of a lending business
- loans between companies in the same group

- loans subject to adequate security
- credit provided to a shareholder–employee directly or indirectly, who does not own more than 5% of the company's shares.

5.23 The Norwegian rule does include a de minimis threshold, with any loan below NOK100,000 (approximately NZ$17,000) not being subject to the rules. If the loan exceeds this amount, the entire loan balance will be subject to the rules.

5.24 If the loan is subsequently repaid, the tax will not be refunded. Rather, the loan repayment is treated as a contribution of capital by the shareholder to the company.

5.25 The Norwegian legislation contains specific anti-avoidance rules to prevent back-to-back loans and loans that are repaid and subsequently drawn down being used to avoid the tax.

Summary

5.26 Many jurisdictions have rules that treat a shareholder loan as a dividend if the loan is not repaid within a prescribed period. We understand that these rules have resulted in the majority of loans being repaid within the specified period. The period varies depending on the country:

- Norway requires a loan to be repaid within 60 days of the date it was made.
- The UK's rules apply to loans that have not been repaid within nine months after the end of the tax year.
- Canada's rules apply to loans that remain outstanding 12 months after the end of the tax year.
- Australia requires the loans to be properly documented, and to be repaid within either 7 years or 25 years (if secured over real property). For undocumented loans, the Australian rules apply if the loan is not repaid within 10 months after the end of the tax year.

5.27 A significant difference between the rules in these jurisdictions is the level of exceptions to the time-based rule. An exception for loans made in the ordinary course of a lending business appears sensible and was common across all jurisdictions. Australia's rule has a number of broad exceptions (see paragraph 5.5). In contrast, the UK and Canada have a few narrow exceptions to their rules.

5.28 Each jurisdiction has also implemented anti-avoidance measures to prevent manipulation of repayments to defeat the application of the rules.

5.29 We understand that the Australian approach has created a complex regime that makes it difficult for taxpayers and the tax authority to determine whether the rules apply. Complex and uncertain rules can lead to lower levels of compliance and increased compliance and administrative costs for taxpayers and Inland Revenue.

5.30 As discussed in more detail in Chapter 6, we consider that a simple rule with fewer exceptions would be more effective at addressing the problem described in Chapter 4.

Questions for submitters

Q11. Do you have any experience with the rules in these jurisdictions? If so, can you share your experiences?

Q12. Are you aware of rules from other countries that could work effectively in New Zealand?

Q13. Do you agree that a simpler rule with fewer exceptions would be more effective?

Chapter 6 – Shareholder loans treated as dividend

Introduction

6.1 As discussed in more detail in Chapter 4, our current rules provide an unintended tax advantage when companies lend funds to shareholders, compared with paying dividends, and little incentive for the shareholder to repay those loans.

6.2 A dividend will be taxed at the marginal tax rate of the shareholder, with a credit for any imputation credits attached. In contrast, a shareholder loan will only result in taxable income for the shareholder in two situations:

- interest on the loan is charged at less than a prescribed interest rate, to the extent of the difference, or
- repayment is not required, for example, if the loan is forgiven.

6.3 The tax advantage is usually temporary, because there is a legal obligation on a shareholder to repay the loan. However, the tax advantage can become permanent if the loan is never repaid.

6.4 We are seeking submitters' views on aligning the tax treatment of shareholder loans in New Zealand with the treatment in other countries. In particular, we are considering an option to treat a new loan as a dividend (in its entirety) if the loan is not repaid within a certain period of time of the loan being made. This time limit would not apply if the company's total lending to their shareholders was less than a de minimis (such as $50,000), so ordinary business practices of using loans and drawings to manage short-term cashflow is not affected.

6.5 Inland Revenue proposes that if the measure in this chapter is progressed, it should apply to any new lending that occurs on or after the date of publication of this issues paper. This should ensure the proposed reform would not create a new cashflow pressure on shareholders who have previously borrowed from their companies. Applying any new rule from the date this issues paper is published may be necessary to minimise any integrity concerns and structuring opportunities that could otherwise arise from the existing stock of loans being excluded from the scope of the rule.

6.6 This chapter discusses the potential scope of a deemed dividend rule for New Zealand. We seek input on the proposal generally, as well as some of the specific detailed design features discussed below.

How long before loans are treated as dividends?

6.7 One of the key design features of this proposal is the appropriate length of time after which a loan should be deemed to be a dividend. Too short could result in complexity and compliance issues. Too long could make the rule ineffective in practice.

6.8 As discussed in Chapter 5, international treatment on this issue differs. Norway's tax rules treat company loans to shareholders as dividends unless they are repaid within 60 days. The UK and Canada have more permissive rules. For the UK, the time limit is nine months following the end of the tax year in which the loan was made. Canada provides a 12-month time limit following the end of the tax year in which the loan was made. Australia requires the loan to be either repaid or properly documented within 10 months of the end of the year in which it is made. If properly documented, the Australian rule allows seven years for repayment (unless secured by real property, in which case 25 years is allowed).

6.9 We consider that a very short time period, as is the case in Norway, would create a barrier to companies using short-term loans to manage cashflow, and would not be workable or desirable in the New Zealand context. Australia's longer timeframe would be unlikely to address some of the underlying concerns we have identified with the use of shareholder loans in the New Zealand context. In particular, a longer time period would still allow for the accumulation of large loan balances that can become challenging if a company begins to fail.

6.10 We consider that a time period similar to that in the UK and Canada would uphold the integrity of the tax system, while also catering for the commercial demands of companies. We consider that if a loan balance has been maintained for a period spanning two successive balance dates, there is a stronger case that the loan is providing value to the shareholder and should therefore be taxed as a dividend.

6.11 We therefore propose that a shareholder loan should be treated as a dividend (in its entirety, both principal and any accrued interest) if the loan is not repaid within 12 months of the end of the income year in which it is made. The dividend would arise on the last day of that following year, rather than the year in which the loan is made. In practice, this means that for formal loans the dividend will arise between 12 and 24 months after the loan is made. For overdrawn current accounts, the rule would not apply if the overdrawn balance is less than the de minimis amount for two consecutive balance dates.

6.12 Examples 8 and 9 give simple examples of how the 12-month rule would apply.

Example 8: Application of the 12-month rule to a formally documented shareholder loan

On 22 April 2027, AB Co makes a $500,000 loan to Flora, its sole shareholder. The terms of the loan require full repayment in 2035, with quarterly interest payments in cash.

Under the proposal in this chapter, the loan will be treated as a dividend to Flora 12 months after the end of the income year in which is it made. The loan was made in the 2027−28 income year, which means the balance will be treated as a dividend on 31 March 2029. This is nearly two years after the funds were loaned to Flora.

Example 9: Repayment of current account within 12-month rule

Gerald is the sole shareholder in G Co, which has a standard balance date and manages cashflow with a shareholder current account.

At the end of March 2028, the shareholder current account is overdrawn, with Gerald owing $100,000 to G Co.

During the 2028–29 income year, G Co needs additional funds to carry on its business, so Gerald pays $120,000 into his current account. On 31 March 2029, the shareholder loan account has a positive balance of $20,000.

G Co did not have an overdrawn current account on 31 March 2029, so the new rule will not apply to the amount outstanding at 31 March 2028 because it had been repaid within the 12 months to 31 March 2029.

6.13 We consider that the proposed timeframe of 12 months after the end of the income year in which the loan is made still allows a shareholder to borrow funds from their company for a limited time to manage cashflow without a dividend arising. This recognises that drawings and shareholder current accounts are a common business practice that can be appropriately managed through the payment of a dividend or salary to facilitate repayment of the loan.

6.14 Once the loan has been deemed to be a dividend, the normal rules concerning payment of tax will apply.

6.15 We acknowledge that deeming the loan to be a dividend for tax purposes may result in some additional compliance costs for some taxpayers because the amount would not change its characteristic as a loan commercially, which could result in complexity for some companies and shareholders. However, because we expect most companies will either have shareholder loans below the de minimis amount, or will pay down any larger loans within 12 months following the end of the income year in which the loan was made (including by declaring an actual dividend or a shareholder salary), we consider the added complexity from a deemed dividend would rarely occur in practice.

6.16 Example 10 gives a simple explanation of how the proposed rule would apply.

Example 10: Simple application of proposed rule

Mario is the sole shareholder in M Ltd. M Ltd has a standard balance date.

Starting in June 2026 (after the date of publication of this issues paper), Mario uses the company credit card to pay for his house renovations. At the end of the income year (31 March 2027), the total cost of the renovations (and the amount Mario owes to the company) is $65,000.

Mario does not repay any of the amount, and no shareholder salary or imputed dividend is credited to his current account during the 2027–28 income year. The balance is still outstanding at the end of the following income year. Mario will be treated as having derived a dividend of $65,000 on 31 March 2028. This will be subject to tax at his marginal tax rate.

Mario uses a tax agent so will have until 7 April 2029 to pay the tax on the dividend. If Mario is subject to the provisional tax rules, that would affect this timing.

6.17 We are interested in comments from submitters on whether a dividend arising 12 months after the end of the income year in which the loan is made is appropriate. If not, we are interested in understanding what period would be more appropriate and why.

Who would the rule apply to?

6.18 If implemented, we propose that the rule should have broad application to all shareholder loans made by any New Zealand resident company to any shareholder that is a natural person or a trustee.

6.19 Despite this broad scope, it is our expectation that the proposed rule would mainly apply to companies with a small number of shareholders that are natural persons or trustees. This is because widely-held companies do not typically distribute their profits by way of loan. We do not consider that it is necessary to limit the scope of the proposal to loans by family owned or other close companies, because shareholder loans outside of those contexts can still give rise to the same concerns outlined in Chapter 4.

6.20 The only exclusion we propose from the broad application of the rule would be for any loans made to a shareholder that is a New Zealand-resident company. This is because the funds will remain in a company, and the loan does not replace a dividend that should be taxed at a higher marginal tax rate so will not give rise to the concerns outlined in Chapter 4.

6.21 There may be complexities in applying the rule in cross-border situations. In principle, we do not consider that an exclusion for cross-border loans is appropriate because they can give rise to the same concerns as other shareholder loans. However, exceptions may be appropriate for non-resident shareholders if any dividend paid to the shareholder would not be subject to any effective non-resident withholding tax. This would be the case if, for example, the shareholder is eligible for a zero percent rate under a treaty. We seek submissions on whether the proposed rule should apply to loans made by New Zealand-resident companies to foreign shareholders or by non-resident companies to New Zealand-resident shareholders.

Proposed de minimis threshold

6.22 The Inland Revenue data discussed in Chapter 3 shows that there are a large number of small value loans from companies to shareholders. We propose that the new rule include a de minimis threshold to exclude these smaller loans, significantly reducing compliance costs for those companies and administrative costs for Inland Revenue. This would allow companies to continue to lend small amounts to their shareholders as part of their usual business operations.

6.23 Internationally, the UK has a de minimis threshold (of up to £15,000, approximately NZ$34,000) for loans to a director or other employee and Norway has a de minimis for loans below NOK100,000 (approximately NZ$17,000). Australia and Canada's rules do not have a dollar value de minimis.

6.24 We consider that a de minimis threshold would be an important part of the successful operation of the new rule. A de minimis would ensure that the rule does not apply too broadly, reducing compliance costs for companies with small loan balances.

6.25 We suggest a de minimis whereby any company with outstanding loan balances of less than $50,000 at the end of an income year would not be subject to the proposed rule. Based on our data, about half the companies reporting shareholder loans in the income year ended 31 March 2024 had shareholder loan balances below $50,000.

6.26 Example 11 provides an example of how the de minimis rule could apply, together with the 12-month rule discussed above.

Example 11: Application of de minimis and 12-month rule to overdrawn current account

Sophia is the sole shareholder in S Co, which has a standard balance date of 31 March. She regularly pays for private expenses using a company credit card, and keeps track of the amount owing in a shareholder current account. On 31 March 2028, the shareholder current account is overdrawn, with Sophia owing $10,000 to S Co. The proposed rule would not apply because this amount is less than the de minimis ($50,000).

During the 2028–29 income year, Sophia borrows a further $125,000 and S Co credits a dividend of $50,000 (after tax) to the current account. On 31 March 2029, the shareholder loan account is still overdrawn, with a balance of $75,000. This amount exceeds the de minimis, so the rule will apply if the amount remains outstanding after 12 months.

During the 2029–30 income year, Sophia borrows a further $25,000. S Co did not make a significant profit in that year, so does not credit the current account with a shareholder salary. The outstanding balance has increased to $100,000 on 31 March 2030.

The amount owing by Sophia exceeds the de minimis of $50,000 for two consecutive balance dates, so she would be treated as deriving a dividend of $75,000 (being the amount owing at 31 March 2029) on 31 March 2030.

For tax purposes, this reduces Sophia's shareholder loan balance to $25,000. At 31 March 2031, the net balance remains unchanged at $25,000. This is less than the de minimis, so the amount will not be treated as a dividend.

6.27 We are interested in whether submitters would support a higher de minimis, such as $100,000. While a higher de minimis would remove more companies from the scope of the new rule, we are concerned that it would introduce additional integrity risks and structuring opportunities.

6.28 Any loans that are excluded from being treated as a dividend due to being below the de minimis would still be subject to the current law that apply to loans (that is, the financial arrangements rules and the requirement to charge at least the prescribed rate of interest). They could also be subject to the new rule proposed in Chapter 7, which would treat outstanding loans to be income for the shareholder when the company is removed from the Companies Register.

6.29 We propose that the de minimis apply on a per company basis. This means that all loans made by the company to shareholders (including shareholder current account balances when those accounts are overdrawn) should be combined when determining whether the threshold has been exceeded. This would be simpler to apply than a rule that applied to each shareholder loan individually.

6.30 A rule may be required to aggregate the de minimis for companies with a high degree of common ownership, for example, 90% plus, to prevent this threshold being taken advantage of by the formation of multiple companies with the same or very similar ownership.

6.31 We are interested in submitters' views on whether the proposed de minimis of $50,000 per company is appropriate and, if not, what a suitable de minimis would be.

Possible exceptions to proposed new rule

6.32 Consistent with the approach in other jurisdictions, it may be desirable to exclude loans with certain characteristics from deemed dividend treatment. While exclusions would add legislative complexity to the proposed rule, they could help the proposal operate more effectively and could reduce compliance costs overall by excluding some loans from the scope of the rule. Some exceptions that could be considered are:

- **Capital gains:** As set out in Chapter 2, under current law a company's net capital gains can only be distributed to shareholders tax free on liquidation. An exception for loans made out of capital gains would enable shareholders to access those gains tax free without liquidating the company and would ensure consistent treatment with other businesses that can derive capital gains tax free (such as those operated by sole traders, partnerships or look-through companies). However, allowing shareholders to access the capital gains of a company would be contrary to a long-standing policy that capital gains can only be paid out tax free on liquidation. Given the fungibility of money, it would be difficult for Inland Revenue to ensure that the loan is not being used as a substitute for making a dividend payment of company profits. Consideration would also need to be given to how to treat a loan funded out of a capital gain if the company then has a capital loss. On balance, we do not consider that an exception should be included for loans funded out of capital gain amounts, but we welcome submissions on this point.

- **Loans on commercial terms with proper documentation:** Similar to the approach in Australia, the rule could have an exception for loans on acceptable commercial terms that are formally documented in writing. Our initial view is that this exception would give rise to additional compliance and administrative costs. It is also unlikely to prevent the accumulation of large loan balances so we consider this would not be workable or effective in practice.
- **Employee share scheme:** Loans under an employee share scheme are generally made for the purpose of remunerating employees and (in some cases) attracting new equity into the company. We consider that an exception for these types of loans would be appropriate.
- **Ordinary course of business:** If implemented, the proposed rule should include an exception for loans made by the company to a shareholder in the ordinary course of lending or other business carried on by the company. An example of this would be a loan made by a trading bank or a finance company to a person who holds shares in the company.

6.33 We are interested in feedback from submitters on the possible exceptions listed above, including any comments on how complexity can be managed if these exceptions were made. We would also be interested to hear about any other exceptions that submitters think may be appropriate.

Impact on existing loans

6.34 As discussed in Chapter 3, there is a large stock of existing shareholder loans. This proposal will not apply to any shareholder loan balances that are already outstanding before the date of publication of this issues paper, unless there is a material variation to the terms of the loan after introduction of the rules. This means that existing outstanding balances will not immediately be treated as a dividend if this proposal proceeds.

6.35 The measure in this chapter will apply to new lending that occurs on or after the date of publication of this issues paper. This will include increases to existing shareholder current accounts, any interest accruing to existing loans that is capitalised to the loan balance, and when there is a material variation to the terms of the loan.

6.36 Despite the exclusion of existing loan balances from the scope of the rule, Inland Revenue proposes that it would be taken into account when determining whether a company exceeds the de minimis. The de minimis is intended to remove companies with small loan balances from the scope of the new rule, rather than allowing all companies an additional $50,000 tax-free threshold before the rule applies.

6.37 Example 12 provides a simple example of how existing loans would interact with the de minimis.

Example 12: Interaction between de minimis and existing loans

Welby is the sole shareholder in W Co, which has a standard balance date of 31 March. Welby borrowed $500,000 from W Co in 2020 to fund the purchase of his family home. He pays interest on that loan. The principal is only repayable once the family home is sold, but Welby pays regular interest on the loan at a market rate.

The new rule will not apply to this loan because it was entered into before the date of publication of this issues paper.

On 16 October 2026, Welby borrows $10,000 from W Co to travel overseas for a family emergency. The balance remains outstanding on 31 March 2027. The new rule will apply to the new $10,000 loan because the total lending by W Co exceeds the de minimis of $50,000. If Welby has not repaid the new $10,000 loan by 31 March 2028, he will be treated as deriving a dividend of $10,000 on that date.

6.38 We acknowledge that when the existing loan is a shareholder current account with multiple positive and negative entries, there will be some complexity involved in calculating the value of the existing loan balance and whether it exceeds the de minimis, especially given the fungibility of money. We propose that for these companies, the existing loan balance should be treated as the amount shown in their most recently filed tax return. This complexity would not arise for the large number of companies that are expected to have current balances below the $50,000 de minimis because they would only be required to ensure that their balance remains below $50,000 in future years. We invite submissions on whether using the amount showing in a company's most recently filed return is appropriate and, if not, how this complexity could be managed in a way that minimises compliance costs for taxpayers.

Integrity measures

6.39 We consider that rules would be required to ensure the integrity of any deemed dividend proposal implemented. We have not determined what specific rules will be required, however, we consider that it is likely that measures would be needed to ensure that a deemed dividend arises appropriately in the following situations:

- **Series of loans:** A shareholder repays a loan within one year of its drawdown, and then immediately takes out another one. A specific rule to aggregate those loans would be required and is likely to be complicated. Any such measure would not apply to drawings that are repaid by the company paying a shareholder salary.
- **Temporary repayment of loans around balance date:** A rule that looks at loan balances on a balance date can be manipulated by repayments before balance date that are redrawn shortly afterwards. A specific rule or rules would likely be required to prevent this. This may be similar to the UK's anti "bed and breakfasting" rules.
- **Back-to-back loans and similar structures:** A company makes a deposit with a bank that is then used as security for a loan by the bank to a shareholder.

- **Loans from related companies:** A shareholder who is the sole shareholder in two related companies could obtain a loan from each company of less than the de minimis threshold amount.
- **Loans to associates of shareholders:** Loans to a shareholder and any associated persons (other than companies) should be aggregated when applying the proposed rule.

6.40 We are interested in feedback on these situations, and whether there are other situations when specific targeted measures may be required.

Design details

6.41 There will be design features that need to be resolved. We have identified the following issues on which we seek submissions, and we are interested in any other issues or complexities that may arise:

- **Imputation credits:** Under New Zealand's imputation system, a company can attach an imputation credit to the dividend that allows the shareholder a credit for the company tax that has already been paid. In principle, imputation credits should be able to be attached to any dividend paid to a shareholder. However, we have some concerns that attaching imputation credits to the dividend that arises under this proposal would give rise to the potential for streaming. This could be the case if, for example, the company has more than one shareholder and not all the shareholders have outstanding loans. On balance, our initial view is that imputation credits should be allowed. We are interested in submitters' views on whether imputation credits should be able to be attached to the dividend and, if so, in what circumstances. We are also interested in submissions on any other practical issues that could arise.
- **Withholding taxes:** As a matter of general principle, the company should have a withholding tax obligation for the deemed dividend. However, there will be significant complexities with this approach, given that the shareholder will already have had the funds for at least 12 months. We seek submissions on whether the dividend should be excluded from the withholding tax rules. An exclusion from withholding tax would mean that the full tax liability would fall on the shareholder.
- **Treatment of shareholder loan following deemed dividend treatment:** A shareholder loan that has been treated as a dividend under this rule will not cease to be a loan from a commercial perspective. The shareholder will still legally owe a debt to the company. Specific rules will be required in the Income Tax Act 2007 to ensure that any payment of interest or repayment of the principal amount by the shareholder provides the correct tax outcomes. For example, it would be necessary to consider how a repayment is treated for tax purposes and the interaction with the financial arrangements rules. Due to the complexity that would otherwise be required, especially if imputation credits are attached to the dividend, our initial view is that repayment of the loan should simply be ignored for tax purposes. We are interested in submitters' views on any practical issues that could arise and how those could be addressed in the legislation.

Record keeping and reporting

6.42 If implemented, Inland Revenue is likely to make supporting changes to the IR4 company tax return (and the supplementary IR4S, used when there is insufficient space in the paper IR4). The IR4 currently includes a section requiring a company to record, for every shareholder, the amount of any loan to the shareholder, and the current account balance, as well as other details such as shareholder salary and subvention payments.

Questions for submitters

Q14. What is your opinion on the proposal to treat shareholder loans as dividends? Is it fair and workable?

Q15. Is the proposed time period of 12 months from the end of the income year in which the loan is made before the rule applies appropriate? If not, what time period would you suggest and why?

Q16. Do you agree that the rule should apply broadly to all shareholder loans made by any New Zealand-resident company to any shareholder that is a natural person or a trustee?

Q17. Should the rule apply to non-resident companies and shareholders?

Q18. Do you consider that the proposed de minimis threshold of $50,000 is appropriate? If not, what level do you think would be better and why?

Q19. Do you have any views on the possible exceptions to the proposed rule? How would you deal with the complexities that may arise from those exceptions?

Q20. Are there other exceptions that we should consider?

Q21. Do you have any views on our proposal to exclude existing loans from the rule while still including the balance when calculating the de minimis?

Q22. Do you have any comments on how the complexity of applying the de minimis to an existing shareholder current account can be managed? Is using the most recently filed income tax return amount appropriate?

Q23. Do you agree that specific integrity rules are required? Are there any other situations where you consider integrity rules would be necessary?

Q24. Do you have any views on the other design details? In particular, whether the deemed dividend can be imputed, how repayment should be dealt with and the relationship with the financial arrangements rules.

Q25. Do you have any comments on whether changes to the IR4 company tax return would be desirable?

Chapter 7 – Outstanding shareholder loans treated as shareholder income once company ceases

Introduction

7.1 As discussed in Chapter 2, the current tax rules provide little incentive for shareholders to repay shareholder loans. Once a company is removed from the Companies Register it is difficult for Inland Revenue to monitor and assess whether a shareholder has complied with their obligations. We propose improving the law to make it clear that income will arise to the shareholder at, or close to, the time that the company is removed from the Companies Register. This proposal would apply to any company removed from the Companies Register after the date of publication of this issues paper.

7.2 The proposal in Chapter 6 would mean that in many cases, shareholder loans owed to a company about to be removed from the Companies Register would already have been taxed as dividends. However, the rule proposed in Chapter 6 would not apply when, for example, the loan was entered into before the date of publication of this issues paper, had not been outstanding for the necessary period of time, or was below the de minimis threshold.

7.3 The proposal in this chapter is to treat any shareholder loan that is outstanding at the time that the company is removed from the Companies Register as income of the shareholder. This will apply to existing loans if the company is removed from the Companies Register in the future. This proposal is expected to support the ongoing improvements to Inland Revenue's processes and systems discussed briefly in Chapter 2 by removing the uncertainty around when income arises for the shareholder.

7.4 The proposal in this chapter could be progressed separately from the rule proposed in Chapter 6. However, we consider that if implemented in isolation the proposal in this chapter would be less effective at addressing the underlying problem because it only applies at the end of a company's life.

7.5 In addition, even with the process and system improvements currently being worked on by Inland Revenue, enforcing and collecting a tax liability from a shareholder when a company has been removed from the Companies Register would still have challenges. We therefore consider that the proposal in this chapter would work best if implemented together with the proposal in Chapter 6 alongside the process and system improvements.

Loan balance treated as shareholder income on removal from Companies Register

7.6 We propose that when a company is removed from the Companies Register, any outstanding shareholder loan amount (that is, the amount owed by a shareholder to the company) would result in taxable income for the borrower. This rule would apply to all New Zealand resident companies (other than look-through companies).

7.7 This proposal would apply regardless of the reason for the company being removed from the Companies Register. In all cases, if there is an outstanding shareholder loan at the point in time that the company is removed from the Companies Register, it is proposed that there would be income for the borrower.

7.8 This will ensure that the shareholder can be assessed on a clear and timely basis for the tax payable on the transfer of value that has occurred, rather than the loan remaining in existence for an indeterminate period until the Limitation Act 2010 ultimately applies and debt forgiveness income arises.

7.9 This proposal will make compliance and monitoring of the tax liability of shareholders easier, by providing a certain point at which the income arises for the shareholder and can be assessed. This will be further supported by the improved processes currently being worked on by Inland Revenue.

7.10 There are two options for implementing this proposal:

- Deeming a dividend to arise for the shareholder equal to the outstanding shareholder loan balance. This would be a similar rule to the proposal in Chapter 6 and would likely have the same general design features as that rule.
- Ensuring that a base price adjustment is triggered at the time the company is removed from the Companies Register. This would remove the uncertainty that currently exists in financial arrangements rules and could be a simpler solution.

7.11 We seek submissions on whether you agree with the proposal to treat the outstanding shareholder loan as income and which of these options you would prefer.

Design details

7.12 Regardless of the preferred option, there will be design features that need to be resolved.

7.13 We have identified the following issues that would arise for either option:

- **Implementation Date:** As stated earlier, Inland Revenue proposes that this rule would apply to any company removed from the Companies Register after the date of publication of this issues paper. It is likely that there will be companies that are removed from the Companies Register before legislation can be enacted. This means the legislation will have retrospective effect, as some shareholders could be subject to tax on the outstanding shareholder loan balance before the legislation is enacted. Inland Revenue considers that having the rule apply from the date of publication of this issues paper is necessary to minimise integrity concerns and structuring opportunities that could otherwise arise. Further, the proposal in this chapter does not result in an amount being subject to tax that would not be income under the current law. Instead, the proposal will make compliance easier by removing uncertainty about when income is derived by the shareholder. We welcome submissions on the impact of the proposed implementation date and whether transitional rules would be required.

- **Look-through companies:** Look-through companies are not taxed the same as other companies, so this rule would not apply when a look-through company was removed from the Companies Register. However, we propose that the rule proposed in this chapter to tax outstanding shareholder loans as income of the shareholder should also apply on the date that a company with outstanding shareholder loans elects to become a look-through company. This is because the same concern about tax not being collected on the loan balance can arise in that situation.
- **Reinstatement of the company**: A company can be reinstated to the Companies Register in some situations. While we do not expect this to happen often, if implemented, the rule would need to deal with it especially if the reinstatement happened in a later year than the removal. One option would be for the rule to only apply to treat the outstanding balance as income after a specific time period had elapsed from the company's removal. For example, the amount could be treated as income three months after the company is removed. This would be aimed at allowing time for reinstatement to take place if a company is inadvertently removed.
- **Integrity measures:** It is possible that further integrity measures would be required to make sure that the rule could not be circumvented inappropriately. We are interested in submitters' views on what measures may be required.
- **Reporting requirements**: Whether this proposal should be accompanied by additional reporting requirements for companies seeking removal from the Companies Register, or for liquidators. For example:
  - Liquidators could be required to file investment income information and a shareholder statement showing the amount of any unrepaid shareholder loans at the end of the liquidation process.
  - Companies seeking a no objection letter from Inland Revenue could be required to file a return confirming (among other things) whether any shareholder loans exist and that they will be treated as income for the shareholder.

7.14 For the deemed dividend option, we consider that additional complexities would arise, such as:

- **Availability of ASC,ACDA and imputation credits:** For the deemed dividend option, it will be necessary to consider whether the deemed dividend can be imputed or can take advantage of the exclusion for a dividend made on liquidation to the extent it is funded by available subscribed capital (ASC) or an available capital distribution amount (ACDA) (section CD 26 of the Income Tax Act 2007). Our initial view is that allowing the exclusion in section CD 26 to apply would be appropriate, but that the dividend would not be able to be imputed.
- **Interaction with the financial arrangements rules:** If the deemed dividend option was implemented, it would be necessary to consider the interaction with the financial arrangements rules. For example, whether shareholder loan forgiveness should also be

treated as a dividend in all cases and how the debt parking rule in section EW 43 of the Income Tax Act would apply to shareholder loans.

7.15 We seek submissions on all these issues. We are also interested in hearing about any other issues or complexities that may arise when treating the loan amount as income.

Questions for submitters

Q26. Do you agree with the proposal to tax any outstanding loans as income of the shareholder when the company is removed from the Companies Register?

Q27. Which of the two options for taxing the outstanding balance would you prefer, and why?

Q28. Do you have any comments on the impact of the proposed implementation date and whether transitional rules would be required?

Q29. How should reinstatement of the company be treated? Would three months be a sufficiently long period to allow reinstatement of companies that are inadvertently removed?

Q30. Do you consider that it would be appropriate to impose reporting obligations on liquidators?

Q31. If the dividend option is progressed, do you have any views on whether the dividend should be reduced by the amount of ASC and ACDA of the company, or should it be able to be imputed?

Q32. If the dividend option is progressed, do you have any comments on the potential interaction with the financial arrangements rules?

Q33. Can you see any other complexities with the proposal that would need to be addressed?

Chapter 8 – Improved record keeping and reporting

8.1 As discussed in Chapter 2, there are no specific requirements for a company to keep records for its available subscribed capital (ASC) or available capital distribution amounts (ACDA), or to report ASC or ACDA to Inland Revenue. However, as set out in operational statement OS 22/01,[8] a company that does not have records to substantiate its ASC and ACDA will lose the benefit of those amounts because it will not be able to satisfy the burden of proof required to take a position that some or all of a distribution is not a dividend.

8.2 We propose amending the Tax Administration Act 1994 to specifically provide for maintaining tracking accounts for ASC and ACDA together with additional record-keeping requirements. These measures would prompt companies to keep appropriate records of relevant transactions and would assist with the future calculation of dividends on liquidation. Maintaining these accounts would significantly improve the reliability of the figures and would also create an opportunity for Inland Revenue to challenge an ASC or ACDA increase, rather than having to wait until a distribution occurs.

8.3 To reduce compliance costs, companies should have the option to elect not to keep a memorandum account and records. However, we seek submissions on whether a company that elected not to maintain records should be deemed to have nil ASC or ACDA.[9] If not, we are interested in submitters' views on how the ASC and ACDA of those companies should be treated, while still improving the incentive for companies to record and report the relevant information.

8.4 The proposals in this chapter are not specifically targeted at shareholder loans and could be progressed separately from the proposals in Chapters 6 and 7. In isolation, the record-keeping proposals would not address the problems described in Chapter 4, but we consider they would be valuable enhancements to the tax system even if none of the other proposals were implemented.

8.5 We propose requiring companies to maintain a memorandum account, similar to the imputation credit account (ICA) for ASC and ACDA. Each account would keep a running total of changes to the amounts – with each year's closing balance forming the opening balance for the next.

8.6 To support the new memorandum account requirements, we propose additional record-keeping requirements that would require companies to keep sufficient records of ASC and ACDA over the entire life of the company (rather than the usual seven-year period).

8.7 There are two possible approaches for tracking accounts for ASC and ACDA:

- **Annual reporting to Inland Revenue:** Companies would be required to submit the memorandum account to Inland Revenue annually. This would enable Inland Revenue

[8] Available Subscribed Capital record-keeping requirements

[9] This may not be a concern because many companies have no more than nominal ASC for their entire existence.

to review and approve the specific treatment of particular transactions in a timely manner and would ensure no surprises for the company if they need to use their ASC and ACDA. This option would have higher compliance and administration costs, but may result in greater certainty.

- **No annual reporting requirement:** Companies would be required to keep and maintain an account and sufficient records, but would not be required to submit these accounts to Inland Revenue unless requested. This option is likely to result in lower compliance and administration costs. However, there would be less certainty for companies and Inland Revenue.

8.8 Under either option, the company would need to maintain sufficient records to confirm the amounts entered in the ASC and ACDA memorandum accounts. It would not be sufficient to simply maintain the memorandum account without retaining the records substantiating the account entries.

8.9 Many existing companies have not maintained up-to-date ASC or ACDA calculations, relying instead on calculating the figure on a retrospective basis using available records if it ever becomes necessary to do so. If this proposal is implemented, we anticipate a number of transitional issues that would need to be considered to ensure that the rules are fair and do not impose too great a compliance burden on companies, such as:

- whether the accounts should only track transactions occurring after the requirements come into effect, and
- how historical transactions should be accounted for when the company uses its ASC or ACDA.

8.10 We welcome submissions on these and any other transitional issues that submitters identify.

Questions for submitters

Q34. What are your views on the proposal that ASC and ACDA memorandum accounts be required to be maintained?

Q35. Should tracking accounts be required to be reported to Inland Revenue annually? If not, why not?

Q36. Is it appropriate to treat a company that does not maintain a memorandum account as having ASC and ACDA of zero? If not, how should those companies be treated?

Q37. What are your views on the transitional rules that may be required. In particular, how should historical transactions be dealt with?

Q38. Are there other options we should consider for improving the reliability of information held by companies and Inland Revenue on ASC and ACDA?

Chapter 9 – Treaty of Waitangi considerations

9.1 The Government's Treaty of Waitangi (Treaty) responsibilities relating to the proposals discussed in this issues paper require consideration of Treaty interests and, if Treaty interests may be affected, engagement with the principles of the Treaty. This chapter specifically considers Treaty interests relevant to shareholder loans, and the relevant Treaty principles that warrant engagement.

9.2 Inland Revenue does not collect ethnicity data and so does not have adequate data on Māori companies and how many of those companies use shareholder loans. In the absence of adequate data, our analysis of the effect the shareholder loan proposals may have on Māori companies has been informed by published studies and recent engagement with Māori on other tax policy matters.

Relevant Treaty interests

9.3 There are a variety of Treaty interests in the tax system, generally. We consider that the interests that are particularly relevant to shareholder loans are economic and development interests. These arise for Māori companies, specifically, including those that may elect to be Māori authorities.

9.4 The legal characteristics of Māori companies are the same as other companies. While the option to use shareholder loans is available to Māori companies, the degree to which they use shareholder loans is not clear. The use of shareholder loans may be constrained by considerations that are unique to Māori companies, including cultural obligations and legislative restrictions on asset alienation and membership.

Treaty settlement commitments

9.5 Inland Revenue is not aware of any Treaty settlement commitments that establish obligations on tax settings, including for shareholder loans.

Treaty principles

9.6 The Treaty principles relevant to shareholder loans include active protection and partnership. Active protection requires the Crown to give appropriate priority to, and take reasonable steps to protect, Māori interests. Partnership requires the Crown and Māori to act reasonably and in good faith. There are no statutorily recognised Treaty principles in tax law.

Treaty implications

9.7 The degree to which our concerns with shareholder loans may be applicable to Māori companies will depend on tax settings, as well as other constraints, that may be unique to Māori companies.

9.8 There is a risk that, if the proposals are not designed well, the impacts on Māori companies may be disproportionate, either positively or negatively, compared to other companies. Inland Revenue is interested in understanding how we can ensure that our proposals impact Māori companies equally.

9.9 The proposal in Chapter 6 to tax the new shareholder loans as a dividend after a set period of time is expected to have direct implications from a Treaty perspective. While the proposal could potentially have disproportionately negative impacts for Māori companies, a de minimis threshold could be disproportionately positive and the proposed exemption for shareholder loans made in the ordinary course of business is also anticipated to be positive.

9.10 We consider that the proposals in Chapters 7 and 8 would not have a disproportionate impact for Māori companies. However, we accept that this depends on whether the assumptions we have made are accurate and how the proposals are designed.

Questions for submitters

Q39. Do you have any feedback on how the proposals may impact on Treaty interests, including for Māori authorities?

Q40. Do you have any feedback on how the proposals could be designed to protect or mitigate any impact on Treaty interests?

Appendix – Questions for submitters

Chapter 2 – Context and background – current law

Q1. Do you think this is an accurate summary of the current law? Do you think there are any other rules that are relevant?

Q2. Are there other reasons why shareholders take drawings or loans from their companies?

Q3. Do you think New Zealand's current laws for taxing company payments to their shareholders are well understood and complied with?

Q4. In your experience do companies maintain reliable records of their ASC and ACDA? If not, why not?

Chapter 3 – Inland Revenue data on shareholder loans

Q5. Are you aware of any reason for the reduction in shareholder loans in 2024, other than the change in the trustee tax rate?

Q6. Does the data on the use of drawings and other loans to shareholders reflect your observations or experience?

Q7. Do you agree that shareholder loans are often linked with company failure?

Chapter 4 – Summary of problem

Q8. Do you agree the current tax rules provide an unintended tax advantage when companies lend funds to shareholders compared with paying taxable dividends?

Q9. Do you agree that the taxation of shareholder loans can be improved?

Q10. Do you have any other comments about the problem?

Chapter 5 – International treatment of shareholder loans

Q11. Do you have any experience with the rules in these jurisdictions? If so, can you share your experiences?

Q12. Are you aware of rules from other countries that could work effectively in New Zealand?

Q13. Do you agree that a simpler rule with fewer exceptions would be more effective?

Chapter 6 – Shareholder loans treated as dividend

Q14. What is your opinion on the proposal to treat shareholder loans as dividends? Is it fair and workable?

Q15. Is the proposed time period of 12 months from the end of the income year in which the loan is made before the rule applies appropriate? If not, what time period would you suggest and why?

Q16. Do you agree that the rule should apply broadly to all shareholder loans made by any New Zealand-resident company to any shareholder that is a natural person or a trustee?

Q17. Should the rule apply to non-resident companies and shareholders?

Q18. Do you consider that the proposed de minimis threshold of $50,000 is appropriate? If not, what level do you think would be better and why?

Q19. Do you have any views on the possible exceptions to the proposed rule? How would you deal with the complexities that may arise from those exceptions?

Q20. Are there other exceptions that we should consider?

Q21. Do you have any views on our proposal to exclude existing loans from the rule while still including the balance when calculating the de minimis?

Q22. Do you have any comments on how the complexity of applying the de minimis to an existing shareholder current account can be managed? Is using the most recently filed income tax return amount appropriate?

Q23. Do you agree that specific integrity rules are required? Are there any other situations where you consider integrity rules would be necessary?

Q24. Do you have any views on the other design details? In particular, whether the deemed dividend can be imputed, how repayment should be dealt with and the relationship with the financial arrangements rules.

Q25. Do you have any comments on whether changes to the IR4 company tax return would be desirable?

Chapter 7 – Outstanding shareholder loans treated as shareholder income once company ceases

Q26. Do you agree with the proposal to tax any outstanding loans as income of the shareholder when the company is removed from the Companies Register?

Q27. Which of the two options for taxing the outstanding balance would you prefer, and why?

Q28. Do you have any comments on the impact of the proposed implementation date and whether transitional rules would be required?

Q29. How should reinstatement of the company be treated? Would three months be a sufficiently long period to allow reinstatement of companies that are inadvertently removed?

Q30. Do you consider that it would be appropriate to impose reporting obligations on liquidators?

Q31. If the dividend option is progressed, do you have any views on whether the dividend should be reduced by the amount of ASC and ACDA of the company, or should it be able to be imputed?

Q32. If the dividend option is progressed, do you have any comments on the potential interaction with the financial arrangements rules?

Q33. Can you see any other complexities with the proposal that would need to be addressed?

Chapter 8 – Improved record keeping and reporting

Q34. What are your views on the proposal that ASC and ACDA memorandum accounts be required to be maintained?

Q35. Should tracking accounts be required to be reported to Inland Revenue annually? If not, why not?

Q36. Is it appropriate to treat a company that does not maintain a memorandum account as having ASC and ACDA of zero? If not, how should those companies be treated?

Q37. What are your views on the transitional rules that may be required. In particular, how should historical transactions be dealt with?

Q38. Are there other options we should consider for improving the reliability of information held by companies and Inland Revenue on ASC and ACDA?

Chapter 9 – Treaty of Waitangi considerations

Q39. Do you have any feedback on how the proposals may impact on Treaty interests, including for Māori authorities?

Q40. Do you have any feedback on how the proposals could be designed to protect or mitigate any impact on Treaty interests?