

27 October 2015

Loss grouping and imputation credits
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
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Loss grouping and imputation credits: an officials' issues paper

Introduction

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on *Loss grouping and imputation credits: an officials' issues paper* (issues paper). Following some general comments relating to the proposals, the Law Society comments on the specific content of the issues paper.
2. Statutory references are to the Income Tax Act 2007 (the Act) unless otherwise specified.

General Comments

3. The Law Society welcomes the proposal in the issues paper to address the over-taxation of corporate profits. We agree that this should positively encourage minority shareholders' participation in companies post mergers and acquisitions, and continued holdings in partial corporate listings.
4. The proposal to enable a loss company to transfer imputation credits to a profit company in conjunction with a loss offset is a logical solution, but the complexity of administering the transfers should be addressed when developing the proposal further. It would also be worthwhile to compare the proposal against alternative solutions, in particular an extension of the inter-corporate dividend exemption to non-wholly owned groups of companies. That extension may be able to be combined with a broader application of imputation grouping to achieve a similar result as imputation credit transfers, but with less complexity.

Specific Comments

5. The Law Society agrees that the proposed imputation credit transfer will achieve the aim of equalising the tax treatment between a wholly owned group engaging in loss grouping and a non-wholly owned group undertaking an equivalent loss grouping (where the loss company has sufficient imputation credits to compensate minority shareholders).

Chapter 3: Timing of the imputation credit transfer

6. The Law Society is concerned about the proposed period of time between the loss grouping and the imputation credit transfer (paragraph 3.21 of the issues paper). In particular, delaying the imputation credit transfer until the time that the profit company pays the dividend utilising the imputation credit will add complexity should there be changes in shareholdings during that period.
7. Shareholders in the profit company at the time of the reduction in profits, rather than subsequent shareholders, should be entitled to the imputation credits. Delaying the imputation credit transfer will benefit new shareholders who were not shareholders at the time of the loss offset.
8. The need to track loss grouping transactions in order to make imputation credit transfer elections in future years may make the use of imputation credit transfers too complicated to administer and therefore less effective for minority shareholders. The complexity of administering the rules will not be helped by the proposal to require imputation credit transfers to occur within four years of the balance date of the return that included the loss grouping (paragraph 3.25).
9. The Law Society recognises Inland Revenue's desire to protect the tax base against imputation credit shopping, but expects that a loss company would not agree to an imputation credit transfer if that resulted in a debit balance in its imputation credit account. The risk of imputation credit shopping may therefore be minimal.
10. To address the concern about imputation credit shopping, a more straightforward alternative would be to transfer the imputation credits at the outset, but require that they be attached to dividends paid by the end of the income year following the loss offset. The loss company would need to have sufficient imputation credits so as not to have a debit balance at year end. This would be less effective, but it would be easier to manage and more certain for minority shareholders.

Chapter 3: Amended assessments

11. Once an imputation credit transfer has been made, the imputation credit accounts of the minority shareholders should not be able to be adjusted where the Commissioner amends the assessments of the profit company and/or the loss company. The need for certainty for minority shareholders should be paramount and any cost should be suffered by the profit company and/or the loss company.

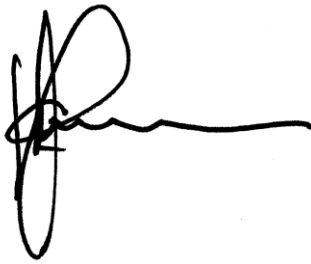
Alternative approach

12. The Law Society recommends that the Commissioner compare the proposal in the issues paper against alternative approaches, such as an extension of the inter-corporate dividend exemption to apply to non-wholly owned groups. That could be combined with imputation grouping for non-wholly owned groups to achieve a similar result as imputation credit transfers, potentially with less complexity.

Conclusion

13. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours sincerely

A handwritten signature in black ink, appearing to be 'Chris Moore', with a long horizontal flourish extending to the right.

Chris Moore
President