

3 June 2025

Tax Technical

Inland Revenue Department

By email: [public.consultation@ird.govt.nz](mailto:public.consultation@ird.govt.nz)

Tēnā koe,

**PUB00469: Income Tax – Whether an off-market share cancellation is made in lieu of the payment of a dividend**

1. The New Zealand Law Society Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to provide feedback on PUB00469, a draft interpretation statement considering the application of s CD 22(6) and (7) of the Income Tax Act 2007 (**ITA**) in relation to the factors to be taken into account in determining whether an off-market cancellation of shares is made in lieu of the payment of a dividend.
2. We welcome Inland Revenue's decision to update IS2966. It has been some time since IS2966 was issued, and the updated interpretation statement is very welcome for taxpayers. Usefully, it provides several examples which can be utilised by taxpayers as guidance when assessing whether the proceeds of a share cancellation will be outside of the dividend definition and not treated by the Commissioner as being "in lieu of the payment of a dividend."
3. The Law Society's feedback is set out below.

**Paragraph 13 – 'small parcels'**

4. Paragraph 13 refers to the brightline tests as treating repurchases of "small parcels of shares" as dividends and repurchases of "larger parcels as tax free".
5. In fact, satisfaction of the brightline tests is not subject to a large parcel of shares being repurchased. It could well be the case that a small parcel of shares is cancelled but the brightline tests are satisfied.
6. For example, a company may have 20 million shares on issue held by four shareholders in equal proportions. The company could repurchase one share from each shareholder – obviously a very small parcel – but the brightline test may nevertheless be satisfied if the amount paid on the repurchase exceeds the 15% capital production test applicable to a pro-rata cancellation.

**Paragraph 18 – Application for a notice from the Commissioner**

7. Paragraph 18 concerns a share repurchase involving a capital reduction which is less than a 15% capital reduction but more than a 10% capital reduction. In that case the Commissioner is required to provide notice that the cancellation is not in lieu of a dividend in order that the exclusion from dividend treatment applies.

8. It is submitted that the wording of section CD 22(8) allows for taxpayers to apply for that notice *subsequent* to the relevant share cancellation being effected. It is not clear what the Commissioner's position is with respect to this in the interpretation statement.
9. If the Commissioner disagrees (i.e. his view is that the notice must be sought and given *before* any proposed share cancellation), then this should be expressly stated in the interpretation statement.

#### **Paragraph 29 – Presence of ‘avoidance’**

10. Paragraph 29 suggests that the ability of the Commissioner to deem the proceeds of a share cancellation to be in lieu of a dividend is intended by Parliament to apply where "avoidance is present".
11. It may well be the case that an amount paid on a share cancellation is "in lieu of the payment of a dividend" where there is no tax avoidance. For example, a New Zealand company may be owned by an offshore parent company which has full treaty protection in relation to dividends received from its New Zealand subsidiary. An amount paid on a share cancellation which is excluded from being a dividend will not result in any tax (assuming the shares are on capital account). Similarly, if the Commissioner applies the "in lieu of dividend" test, and a dividend arises, there is no tax avoidance. We therefore consider it is not correct to assert that the "in lieu of dividend" test is applied only in cases where there is avoidance.

#### **Paragraph 38 and Example 2**

12. Paragraph 38 and Example 2 suggest that the length of time between the cancellation and issue of shares is irrelevant to whether the in lieu of dividend test is applicable.
13. There may be intervening circumstances between a relevant share cancellation and subsequent share issuance which does not mean that the share cancellation is in lieu of a dividend. For example, if one has regard to the Covid-19 pandemic, that necessitated significant capital raisings by New Zealand companies that would not in any sense have been anticipated before the pandemic.
14. The Commissioner should recognise that even where there is a short period of time between a cancellation and subsequent issuance, intervening circumstances may be such that the short period of time has no bearing upon whether the cancellation is in lieu of the payment of a dividend.

#### **Paragraph 48 – Group restructure**

15. Paragraph 48 states a share cancellation may be a necessary step in reorganising the ownership or corporate structure of the relevant group. The Commissioner then provides examples of such restructuring transactions. However, there is no comment provided in relation to those examples, which would be welcome.

**Paragraph 50 – Return of surplus capital**

16. Paragraph 50 provides that if "surplus capital merely represents earnings retained" to satisfy the brightline criteria, that factor will support application of the in lieu of dividend test.
17. Retained earnings from a financial reporting perspective could well include the proceeds derived from the sale of capital assets, for example divestment by a company of a particular business division. Those retained earnings should be able to be distributed without being a dividend (given that they represent surplus capital), without application of the in lieu of dividend test.
18. It is not the fact that there are retained earnings, rather it is the nature of the retained earnings that is relevant to application of the in lieu of dividend test. If the retained earnings represent prior years' operating income, then that may well be a factor in application of the in lieu of dividend test. This should be clarified in the interpretation statement.

**Paragraph 52 – Balance sheet restructure**

19. The Commissioner states that a company may restructure its balance sheet to achieve financial goals through cancelling shares. There is no comment in the interpretation statement as to the view that the Commissioner would take of actions described in paragraph 52, in terms of application of the in lieu of dividend test.

**Paragraph 55 – Change in shareholding interest**

20. Paragraph 55 suggests that a minimal change in ownership arising on a share cancellation could indicate that the payment with respect to such a share cancellation is in lieu of a dividend.
21. It is routinely the case on a pro-rata cancellation, particularly in a non-listed context, that every shareholder participates in the share cancellation and there is no change in ownership interest.
22. In a listed company context, it may often be the case that a significant shareholder wishes to participate in the share cancellation and does not want to see any dilution of its interests (this would particularly be the case with a shareholder having a 51% shareholding). Where that is the case, our experience would be that the share cancellation is effected pursuant to a High Court approved scheme of arrangement which binds every shareholder to participate in a pro-rata offer. Where that is the case, there is no change in shareholding interest.
23. Therefore, we consider the Commissioner's statement that a "minimal change" could indicate that the in lieu of dividend test is to be applied is far too broad and is inconsistent with what occurs as a matter of commercial practice.

**Paragraph 62 – Non-participating redeemable shares**

24. The interpretation statement provides that undertaking regular redemptions of non-participating redeemable shares provides an avenue for making payments which are in lieu of the regular payment of dividend.

25. We consider the statement should recognise that non-participating shares are in substance debt. If a company had issued debt, there would be no issue about regular principal repayments of that debt using retained earnings. Where funding is by way of debt, as opposed to non-participating shares, it would never be suggested that part repayments of that debt are in lieu of the payment of interest. We would see the non-participating redeemable shares in no different character from a tax perspective, and consider the interpretation statement should acknowledge this is the case.

**Next steps**

26. Should you wish to discuss any aspect of this feedback, please contact Aimee Bryant, Manager Law Reform and Advocacy ([aimee.bryant@lawsociety.org.nz](mailto:aimee.bryant@lawsociety.org.nz)).

Nāku noa, nā

A handwritten signature in grey ink, appearing to read 'Jesse Savage'.

Jesse Savage  
**Vice President**