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Te Tari Taake

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Qualifying companies

A guide to qualifying company tax law

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Introduction

This guide has information about qualifying companies. There's a list on page 31 for terms that you may not be familiar with, or that are used differently from their everyday meaning.

Only companies that were QCs prior to their income year starting on or after 1 April 2011 are able to continue using the QC rules. New and existing companies cannot elect to be a QC.

For legislation specific to QCs refer to subpart HA of the Income Tax Act 2007.

Unless otherwise noted all references are to the Income Tax Act 2007.

Contents

Part 1 – What are qualifying companies

Qualifying company (QC)

QCs are companies governed by tax provisions that aim to treat the company and its shareholders as one entity as much as possible for income tax purposes.

A QC pays income tax on its profits in the same way as other companies (subject to certain rules as outlined in Part 7). However, there are some differences that result in advantages and disadvantages to becoming a QC as outlined below.

Advantages of being a QC

- There are commercial benefits in maintaining a company structure with the taxation benefits of a partnership (eg, limited liability and the ability to transfer ownership).
- Only dividends with imputation credits attached are taxable to the shareholders.
- Capital gains (realised and unrealised) can be distributed tax free without winding up the company.

Disadvantages of being a QC

- Shareholders are liable for any unpaid income tax for the company according to their effective interest.
- If a QC is in a profit situation it can only make a subvention payment to another group company if it is also a QC. Also, a QC in a profit situation can also only receive a loss offset from another group company if it is a QC.
- Interest shareholders have paid to acquire shares isn't fully deductible.

For a more detailed comparison of the differences between a QC and a company for tax purposes, please refer to the following table.

Differences between a QC and a company for tax purposes

	QC	Company
Requirements that must be met		
Investment restrictions	Derive a maximum of NZ$10,000 foreign-sourced non-dividend income per year. It mustn't have, at any time, any income interest in a controlled foreign company or an attributing interest in a foreign investment fund that is a direct income interest of 10% or more.	None
Shareholding	Limited to five (subject to shareholder count test) A shareholder that is a company must be a QC Change in shareholding may require re-elections and could result in a deemed revocation of QC status	None
Tax liability	Shareholders liable for unpaid income tax	None (except section HD 15)
Foreign company	Can't be a qualifying company	Can be a New Zealand resident company
Distributions		
Dividends	Imputation credits fully attached or exempt	Taxable
Shareholder-employee salaries	Deductible to the company and assessable to the shareholder-employees	Deductible to the company and assessable to the shareholder-employees

	QC	Company
Capital dividends	Exempt from income tax	Tax free on winding up only
Dividends to non-residents	NRWT must be deducted and paid on all dividends	NRWT must be deducted and paid on all dividends
Imputation credits received	Credit to imputation credit account (ICA) and offset against tax liability	Credit to ICA and offset against tax liability
Share repurchases	Excess classed as ordinary dividend to shareholder	Excess liable for FBT unless shareholder elects to be assessed
Income or losses		
Losses	A QC in profit can only receive a loss offset from another group company if it is also a QC. A QC in profit can only make a subvention payment to another group company if it is also a QC.	General rules apply
Fringe benefits		
To shareholders	Non-deductible and non-assessable	Non-deductible and non-assessable
To shareholder-employees	Deductible by company, non-assessable to shareholder-employees, but subject to FBT	Deductible by company, non-assessable to shareholder-employees, but subject to FBT
Other		
Interest paid to acquire shares	Apportionment required	Deductible
	QC	**Company**
ICA		
Credits carried forward	66% rule only applicable if qualifying company status is forfeited	66% rule

Part 2 – Who can be a QC

Requirements of a QC

To maintain QC status, all the following requirements must be met for the whole of the income year.

- The company must not be a foreign company at any time during the year. However, a company that has non-resident shareholders will not necessarily be excluded from becoming a QC.
- The company mustn't have, at any time any income interest in a controlled foreign company or an attributing interest in a foreign investment fund that is a direct income interest of 10% or more.
- The company must not be a unit trust.
- The company must not receive more than NZ$10,000 in foreign-sourced **non-dividend** income per year. To determine the $10,000 limit, a deduction is made for the lesser of:
  - gross foreign non-dividend income (accrual income)
  - 10% of the company's annual gross income before any deductions. Please note, it is necessary to consider where the income is sourced to determine when the $10,000 limit applies.
- Each shareholder must be: a natural person, a QC or a trustee of a specified kind.
- If a shareholder in a QC is a trustee:
  - every beneficiary of the trust which received dividends from a QC must be either a person or a QC.
  - the trustees must distribute dividend income (including cash and taxable bonus issues) derived from a QC during the income year to beneficiaries as beneficiary income. Normal trust rules apply in that the income must be paid or applied within six months of balance date. These rules are relaxed when the trust pays or vests as much of the dividend income as is allowed under general trust law.
- The number of shareholders in the company must not exceed five, unless it is purely a flat-owning company (see page 31). There are special rules for determining the number of shareholders for QC purposes - see "Shareholder count test" on page 9.

- Valid elections must be in place for the whole of the income year to maintain QC status. Re-elections must be completed and filed with us within the grace period - see Part 3.
- QC status must not be revoked, whether through a voluntary revocation or an automatic revocation see Part 4.
- Starting 30 March 2017 there must not be a significant change in the QC's shareholding - see "Change in control during QC continuity period causing automatic revocation" on page 19.

Shareholder count test

Shareholder count test for individual shareholders

The maximum number of shareholders for a QC is five. For some companies, it will be obvious that they meet this requirement without needing the shareholder count test. For example, a company that has three individual shareholders clearly has fewer than five shareholders. However, for companies that have more than five individual shareholders, or that include non-individual shareholders (ie, a company or a trust shareholder) the shareholder count test needs to be considered.

The shareholder count test determines the number of shareholders a company has for QC purposes through identifying the relationships between individual shareholders and applying the "look-through" test for non-individual shareholders.

Shareholders related by blood relationship, marriage, civil union or de facto relationship, or adoption, are seen as being related within one degree and are counted as a single shareholder for QC purposes.

To clarify the degrees of separation in a relationship between individual shareholders, think of a family tree. Count the steps back to a common ancestor and then forward to the other person. Each link is a one-degree relationship. Shareholder relationships with two degrees of separation between them are still counted as two separate shareholders for QC purposes.

Parent

Son Daughter

In the example above, if all three are shareholders in a company, they are counted as a single shareholder because the son and daughter are related to the parent within one degree. But, if the parent was not a shareholder, the brother and sister would count as two shareholders because they are related within two degrees. The relationship between a step-parent and step-child is a second-degree relationship for QC purposes.

Shareholder count test for company shareholders

Only companies that are also QCs may hold shares in a QC (except when they are acting as a nominee). In determining whether there are five or fewer shareholders, the company is not counted as a single shareholder. Instead, you must "look through" to its individual shareholders and identify the relationships between them to determine the shareholder count (see the company shareholders example below).

Shareholder count test for trust shareholders

If a trust is a shareholder, it is necessary to "look through" to the beneficiaries of the trust. It is the beneficiaries who are counted to determine the shareholder count for a trust. The number of beneficiaries will be the greater of:

- the number of beneficiaries who have received dividends from the trust in that income year where all the dividends were derived from a QC, or
- the number of beneficiaries who elected that the company become a QC.

Note

In most circumstances, trusts, as shareholders of a QC, are required to pass out dividends to beneficiaries.

Shareholder count test for nominee shareholders

Shares held on behalf of a person are deemed to be held by that person. If a nominee shareholder is a trust or another company rather than a person, this alone will not prevent a company from becoming a QC.

Special rules for shareholder count test

- Death or dissolution of marriage or civil union of the shareholders doesn't break the one-degree test, provided the company was a QC and the shareholders were considered to be "one" before the event.
- Holders of debentures to which section FA 2 applies are treated as shareholders.

Examples that meet the shareholder count test

Company shareholders

Company C Ltd has the following shareholding:

		34% Luke		
50% Company D Ltd	-	33% Harry	brothers	3
		33% Ben		
50% Company E Ltd	-	25% Peter	husband and wife	1
		25% Mary		
		25% Sam	husband and wife	1
		25% Susan		

In this example, Company C Ltd has five shareholders for the purposes of the shareholder count test. The three brothers of Company D Ltd are related within two degrees so they are counted individually. Since a husband and wife are related within one degree, Company E Ltd has two shareholders. If the shareholders of Company E Ltd were not related to each other, the shareholder count for Company E Ltd would be four. Overall, this would result in a shareholder count of 7 for Company C Ltd and it would not be eligible to become a QC.

Trust shareholders

Company B Ltd was incorporated on 1 April 2009 with the following shareholding:

10% Jack				
90% family trust	- trustee	- Jack		
	- beneficiaries	- Sandra (Jack's wife)		
		- Matt		
		- Neve		Jack and Sandra's children
		- Oliver		
		- Piers		

Jack signs the shareholder's elections for Company B Ltd as the individual shareholder and as the sole trustee for the trust shareholder. Sandra signs the shareholder's elections for Company B Ltd as the beneficiary who can legally sign the election for the trust.

Assuming five beneficiaries have received QC dividends through the trust, the company's shareholding, including Jack, totals six. However, since these shareholders are all related within one degree, the company has only one shareholder for the shareholder count test.

Mixed shareholding

Company A Ltd was incorporated on 1 April 2009 with the following shareholding:

40% Bob			
10% Sue (Bob's wife)		1	
13% Phil (Bob's son, aged 21)			
13% Stephen (Sue's brother)		1	
13% Jamie (Stephen's son)			
6% family trust	- trustee	-	Bob
	- beneficiaries	-	Sue
		-	Phil
		-	Jamie
5% Company F Ltd		-	99% Bob
		-	1% Denise (nominee for Bob)

In this example, Company A Ltd has two shareholders for the purpose of the shareholder count test:

1. Bob, plus Sue, Phil (one degree from Bob) and Denise (nominee)
2. Stephen, plus Jamie (one degree from each other).

You may need to apply the test more than once, starting with different shareholders, to arrive at the least number of shareholders.

Note

If it isn't clear whether a company has five or fewer shareholders, supply details of shareholder relationships with the re-elections in order to help us process your request faster.

Part 3 – How to maintain QC status

To be a QC a valid election needed to be made before the income year starting on or after 1 April 2011.

For a company to retain its QC status it must continue to meet all of the requirements to be eligible (see Part 2) and have valid elections in place for the whole of the income year.

Re-elections due to changes in shareholding

When a QC has a shareholding change, the new shareholders must complete and file re-elections with us. The new shareholders must also elect for the company to be a QC and to become liable for any unpaid income tax for the company, according to their effective interest.

Some of the most common changes in shareholding are where existing shareholders - who have previously elected - sell all or some of their shares to a new shareholder or where a company issues shares to a new shareholder. In both of these scenarios, the new shareholder must complete re-elections. However, if a shareholding change involves a transfer of shares between existing shareholders only - who have both previously elected - there is no requirement to re-elect because the shareholders' elections still stand as only their effective interest has changed.

Please refer to the following table for some examples of shareholding changes and whether re-elections are required to be filed.

Types of shareholding changes and action required

Shareholding change	Are re-elections required to be filed?	
	Yes	No
A shareholder dies	✓	
Shares are transferred from an estate to another person	✓	
A minority shareholder, who had a majority shareholder previously elect on their behalf, becomes a majority shareholder	✓	
A majority shareholder, who previously elected on behalf of a minority shareholder/s, becomes a minority shareholder	✓	
A trustee or beneficiary of a trust, or shareholder, who had a volunteer elector sign on their behalf due to being a minor, becomes legally able to sign the election	✓	
A trust shareholder has new trustees	✓	
A shareholder sells part or all of their shares to a new shareholder	✓	
Shares are sold between existing shareholders who have both previously signed valid elections		✓

When are re-elections due?

Re-elections are required to be filed with us within 63 days - the grace period - of the shareholding change. An exception to this is where the shareholding change is due to the death of a shareholder; in this case the grace period is extended to 12 months. If re-elections aren't filed with us within this period, a company's QC status is lost - referred to as an automatic revocation - from the beginning of the tax year in which the shareholding change occurred. If the automatic revocation occurred in a tax year starting on or after 1 April 2011 the company will lose its QC status and be unable to elect back into the rules.

We have some discretion to consider requests to extend the grace period or defer the date of revocation when re-elections are filed late. Such requests should be in writing and attached to the late re-elections, and need to clarify the following points:

- The event and date that made the company and/or tax agent realise the re-elections hadn't been filed within the grace period.
- Reasons why the re-elections were filed late.

How to complete re-elections

Use the *Qualifying company re-elections (IR436)* form to make the re-election.

It is generally only the new shareholders who need to sign if valid elections are still in place for the existing shareholders. There may be exceptions where the original elections involved majority elections or volunteer elections and the shareholding change involves these shareholders.

Shareholder liability

The shareholders' liability for the QC's income tax is based on the shareholders' effective interest in the company. Shareholders who can legally sign the election are liable for any income tax the company has incurred but failed to pay during the time it is a QC.

Shareholders who hold shares jointly (including trustees, beneficiaries who can legally sign the election and volunteer electors) will have joint and several liability to the extent of their joint effective interest.

Summary of shareholders' liability

Minority	Election made, liability based on effective interest Majority election on minority's behalf, no liability
Majority	Liability based on effective interest Shareholders who make majority elections on behalf of minority shareholders are also liable for those shareholders' effective interest Joint majority elections made with other shareholders, joint and several liability for minority's effective interest
Nominee	Same as for minority
Trustee	Jointly and severally liable with the elector beneficiaries and/or volunteers, based on the trust's effective interest Liability limited to value of trust's net assets
Beneficiaries or volunteers	Same as for trustee

Shareholders' effective interest

A shareholder's effective or voting interest in a company is measured by the percentage of decision-making rights carried by the shares (and options) in a company, in relation to:

- dividends or other company distributions
- the company's constitution
- variation of the company's capital
- director appointments or elections.

Example

A voting interest calculation

A shareholder owns 40% of the shares in a limited company. The shares carry voting rights over distributions made by the company and variation of the capital only.

The voting interest is calculated as:

$$\text{Distributions} + \text{constitution} + \begin{matrix}\text{variation}\\ \text{in capital}\end{matrix} + \text{directors}$$

$$\frac{40}{100} + \frac{0}{100} + \frac{40}{100} + \frac{0}{100} = \frac{80}{100} = 20\%$$

Where a shareholder's economic interest in a company isn't accurately reflected by their voting interest because of other specific factors, the shareholder's effective interest is calculated as the average of the shareholder's voting interest and market value interest in the company.

Market value interest

A shareholder's market value interest in a company at any time equals their share of the total market value of shares (and options) held in the company. There are specific factors that require a market value interest to be calculated - these are called market value circumstances.

These are the situations where a market value circumstance exists.

- The company has debentures on issue to which section FA 2 applies (but not excluded securities or pre-budget securities).
- The company has shares on issue where a third party guarantees dividend payment.
- There is an option, other than an excluded option, to acquire shares in the company.
- An arrangement exists with the purpose of defeating a provision that depends on measuring voting and market value interests.

Rules to determine effective interest

There are some special rules for calculating the effective interest in a company.

- Where the shareholder is another company, there is no "look through" to the ultimate shareholders.
- If the voting interest or market value interest varies during the year, the effective interest for the period is determined on a weighted average basis.
- When a shareholder's election is revoked, the voting and market value interests are nil from the date the revocation takes effect.
- If the shareholder is a trustee, and a beneficiary who can legally sign the election or volunteer elector revokes their election, the trustee's voting and market value interests are nil from the date the revocation takes effect.

Part 4 – How QC status is revoked

Ceasing to be a QC

A company ceases to be a QC in two ways: through a voluntary revocation or through an automatic or deemed revocation.

Voluntary revocation

A *Revocation of qualifying company election (IR437)* may be filed with us when a company chooses to revoke their QC status. To be valid, an IR437 has to be completed by all directors (by signing Section 1 - Directors' revocation) or by one shareholder (by signing Section 2 - Shareholders' revocation). Please note that only shareholders can individually revoke QC status.

When are voluntary revocations due?

When an IR437 is filed with us, the revocation applies from the beginning of the income year in which the form is received unless a later year is specified. We don't have discretion to allow late voluntary revocations to be retrospectively applied.

Example

The Big Bad Wolf Limited has a 31 March balance date. It originally became a QC from 1 April 2009. Later, the board of directors changed its mind about the company being a QC. A director filed an IR437 with us after 31 March 2010. The earliest the revocation can take effect from is 1 April 2010 onwards, so The Big Bad Wolf Limited remains a QC for the 2009-10 tax year. In order for The Big Bad Wolf Limited to revoke QC status from 1 April 2009 onwards, effectively as if never a QC, a valid IR437 was required to be filed with us on or by 31 March 2010.

Please note that once QC status is revoked for a company through a voluntary revocation this can't be reversed, and the company will not be able to elect back into the QC rules.

Automatic revocation

When a company fails to meet one of the requirements to become a QC in Part 2 it automatically loses its status effective from the start of the income year in which the event occurred.

Companies can lose their QC status when there is a shareholding change and valid re-elections aren't filed with us within the grace period (see Part 3). Companies will also lose their QC status if they do not satisfy the shareholder requirements for a QC continuity period (see below). So, it's very important for a company to monitor any shareholding changes once it becomes a QC.

A company can also lose its QC status when any of the following events occurs as the company will fail to meet one of the QC rules.

- A new company shareholder isn't a QC.
- An existing company shareholder loses its QC status.
- A trust shareholder doesn't distribute all of the QC dividend income as beneficiary income.
- A beneficiary of a trust shareholder isn't a natural person or a QC.
- There is a variation in voting and distribution rights attached to shares.
- A company has an income interest in a controlled foreign company or an attributing interest in a foreign investment fund that is a direct income interest of 10% or more.
- Foreign non-dividend income exceeds NZ$10,000 per income year.

Changes in control during the QC continuity period causing automatic revocation

Following a law change in March 2017 a change of control for a QC will result in QC status being lost. A change of control is measured using a shareholder continuity test which requires that the QC's shareholders must maintain minimum voting interests (or market value interests, if a market value circumstance exists) of at least 50% for the period beginning on 30 March 2017 and ending on the last day of the relevant income year (known as the "QC continuity period").

Example

Co X is a QC and has four individual shareholders for the 2018 tax year. None of the shareholders are related and there were no changes to the company's shareholding prior to the 2019 tax year.

Shareholder	% voting interests 31/3/18
Amber	25
Heather	20
Joanne	30
Stuart	25
Total	**100**

During the 2019 tax year, Joanne sells all of her shares to Brian and Stuart sells all of his shares to Harry.

Shareholder	% voting interests 31/3/18	% voting interests 01/1/19	% lowest voting interests
Amber	25	25	25
Brian	0	30	0
Harry	0	25	0
Heather	20	20	20
Joanne	30	0	0
Stuart	25	0	0
Total	**100**	**100**	**45**

Because Co X's shareholders did not maintain minimum voting interests of at least 50% for the QC continuity period it no longer meets the criteria to be a QC.

If a QC loses QC status because of breaching this requirement its status is generally lost from the first day of the income year in which the change in shareholding occurred.

The transfer of shares between close relatives is ignored for the purposes of this test. A close relative is a person's spouse, civil union or de facto partner, and includes another person who is within the second degree of relationship to the person.

If Joanne and Brian were close relatives the transfer of shares would not cause Co X to lose its QC status.

Note

Changes in shareholding resulting from a property relationship settlement or the death of a shareholder are also ignored for the purposes of this test.

What do I do if QC status is revoked automatically?

If a company loses QC status through a shareholding change and is eligible to re-elect, the re-elections should be filed as soon as possible, and an application can be made to extend the grace period or defer the cessation date if they will be filed outside the grace period (see Part 3).

In other cases, companies that don't meet the requirements of being a QC for the entire tax year will lose their status. As elections to be a QC can't be made for income years starting on or after 1 April 2011 the company will not be able to become a QC again.

Please note that where an automatic revocation has occurred, a company - or its tax agent - should advise us in writing of the event that caused the revocation and when this event occurred.

Revocations and effective interest

The date we receive a voluntary revocation, or the date of the event that caused an automatic revocation, is used to determine the effective interest of the person making the revocation unless a later date is specified.

When re-elections are made, they are effective from the beginning of the income year in which the revocation occurred. In order to calculate a shareholder's effective interest when re-elections are made, the date on which the person became a shareholder is taken into account even if this is earlier than the date they made an election.

Example

An elector shareholder, "A" sells her shares on 30 June 2016. This causes an automatic revocation of the QC status effective from 1 April 2016 (assuming the QC has a 31 March balance date).

On 30 July 2016, the new shareholder, "B" re-elects to continue as a QC (within the 63-day grace period). The replacement election is effective as at 1 April 2016. B's effective interest is calculated from 30 June 2016, even though this is earlier than the date on which he made his election.

Liquidating or winding up a QC

Once a company is removed from the Companies Register it is technically no longer a QC. However, the QC won't necessarily lose its status just because the company has ceased. If a company is removed from the Companies Register and is later restored, its QC status is considered to be continuous for that period, providing all other requirements for maintaining QC status are met.

Liquidating companies should be aware that:

- shareholders will still be liable for their share of the company's income tax liability, based on their effective interest in the company and regardless of the status of the company
- the company may be liable for any debit imputation credit account (ICA) balance that may have been deferred.

Part 5 – Distributing dividends as a QC

Dividend imputation system

The dividend imputation system allows companies to pass credits on to their shareholders for the New Zealand income tax paid by the company. This means that shareholders get the benefit of the income tax the company has paid. General concepts of the dividend imputation system are the same for a QC as for other companies' resident in New Zealand, for example:

- Requirement to maintain an ICA.
- Allocation of imputation credits to shareholders by attaching a certain amount of the credits to the dividend payments (ie, imputing the dividends).
- Requirement for New Zealand resident shareholders to include their dividend income and imputation credits in their individual tax returns.
- The amount of imputation credits attached to a dividend is capped relative to the amount of the dividend. This is called the maximum imputation ratio, which is currently 28:72, meaning up to $28 of imputation credits can be attached to every $72 of dividends. Or, the gross dividend can include imputation credits up to 38.88% of the dividend's cash value amount.

Some aspects of the dividend imputation system that are specific to a QC include:

- If a QC attaches imputation credits to a dividend it must attach the maximum imputation credits it has available (fully imputed). Any amount of the dividend over this without imputation credits attached is exempt from tax.
- Dividend statements must advise the amounts of the dividend that are taxable and exempt in addition to advising the amounts of the gross dividend and imputation credits attached. The exempt portion of the dividend is not included in the shareholder's income tax return.
- As long as a QC attaches the maximum imputation credits it has available to a dividend, there is no further tax, eg, RWT (resident withholding tax) to pay in relation to the dividend.

Resident and non-resident shareholders

Dividends paid to New Zealand resident shareholders without imputation credits attached (including non-cash dividends and capital gains distributed) are exempt from income tax and do not have RWT deducted. However, dividends (both cash and non-cash) paid to non-resident shareholders are still subject to NRWT (non-resident withholding tax).

For more detailed information about imputation please refer to our *Imputation (IR274)* guide.

Summary of tax treatment for different types of distributions

- Capital distributions (realised or unrealised) don't have imputation credits attached and are exempt from tax for the company and the shareholders.
- Non-cash dividends aren't assessable to the shareholders and the expenditure incurred in providing them is non-deductible to the company.
- Cash dividends must have imputation credits attached to the fullest extent possible. Any portion of the dividend without imputation credits attached is exempt from tax.
- Exempt dividends received by a trustee shareholder retain their exempt status when passed through to beneficiaries as beneficiary income.
- No dividends paid to New Zealand resident shareholders are subject to RWT.
- All dividends paid to non-resident shareholders are subject to NRWT.

How imputation credits are attached to dividends

Imputation credits can only be attached to cash dividends and taxable bonus issues. When a QC pays a dividend, it must attach the maximum imputation credits available and any amount of the dividend that isn't fully imputed is paid tax free. The amount of the imputation credit is determined using the following formula.

The lesser of:

- maximum imputation credits available under the imputation system, ie, 28/72 or 38.88%
- an amount calculated as:

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

Where:

a is the ICA closing balance of the tax year in which the dividend was paid

b is the amount of the dividend, excluding imputation credits

c is total dividends (excluding imputation credits) paid by the company during the tax year.

Example

Closing ICA balance	\$ 3,000
Cash dividend paid to a shareholder	\$10,000
Total dividends paid by the qualifying company	\$20,000

$$\frac{\$3{,}000 \times \$10{,}000}{\$20{,}000} = \$1{,}500 \text{ maximum imputation credit to be attached to } \$10{,}000 \text{ dividend}$$

Amount of dividend that will be taxable

The amount of a dividend taxable to a shareholder is calculated using the following formula:

$$\frac{a}{b}$$

Where:

a are the imputation credits attached to the dividends

b is the resident company tax rate expressed as a decimal.

The balance over this amount will be exempt.

In the above example, the shareholder received a \$10,000 dividend with an imputation credit of \$1,500 (gross dividend of \$11,500). Using the formula provided, \$6,500 is exempt and \$5,000 is taxable with an imputation credit of \$1,500, that is:

$$\frac{\$1{,}500}{0.28} = \$5{,}357$$

In summary, of the \$10,000 cash dividend received, \$6,143 is exempt and \$3,857 is taxable with \$1,500 imputation credits attached. This makes a gross taxable dividend to return of \$5,357.

Part 6 – Imputation credit account (ICA)

ICA rules that apply to qualifying companies

- Imputation credits are credited to the ICA.
- Imputation credits are attached to a dividend paid and are calculated at the end of the tax year.
- For cash dividends and/or bonus issues, dividend statements must be completed by 31 May following the end of the tax year.
- Dividend statements must show the amount of the dividend that is gross income and the amount that is exempt.
- The shareholder continuity requirement of 66% for maintaining an ICA balance is suspended for QCs.
- Where a company ceases to be a qualifying company there will be a debit to the ICA for the lesser of:
  - the ICA balance at the time the QC status ceases (after attaching the maximum imputation credits to dividends paid during the tax year and up to cessation), or
  - the greatest debit that would have arisen due to the loss of 66% shareholding continuity under the normal imputation rules.
- A QC's income tax refund isn't limited by the credit available in the ICA unless the overpayment is part of a tax avoidance arrangement.
- Companies need to record each QCET payment made after 17 May 2007 as a credit entry in the company's ICA.

Debit balances

Because QCs must retrospectively impute dividends paid during the year to the fullest extent possible, there is also the potential for tax refunds in a subsequent year to result in a debit balance.

Ordinarily, the company would be required to pay further income tax, ie, an amount to clear a debit balance. However, QCs are relieved of any liability created by ICA debit balances that are attributable to tax refunds that have arisen during the year.

Example

A company declares a dividend of $4,060 in the 2012 tax year and has a credit balance of $2,000 (being provisional tax payments). They're required to impute the dividend to the fullest extent possible and attach $2,000. The 2012 return is assessed, and the company receives a $500 refund, which puts the ICA balance into debit. They're not required to pay further income tax. The debit balance will be carried over until payments are made in later years to offset it.

Part 7 – Taxing a QC

Intercompany dividend exemption

The income tax exemption for dividends doesn't apply to QCs that receive dividends from other companies in the same wholly owned group. Any dividends received from other companies in the same wholly owned group are taxable and the QC receiving the dividend may claim any imputation credits attached.

Dividends received from foreign companies in the same wholly owned group will generally remain exempt.

The exemption also does not apply to companies that were previously QCs, unless the:

- dividend is derived at least seven years after the company ceased to be a QC, or
- company never paid an un-imputed dividend while it was a QC.

Subvention payments and loss offsets for a QC

	Loss offset	Subvention payment
QC profit	A QC with a net profit can only receive a loss offset from another group company if it's a QC.	A QC with a net profit can only make a subvention payment to another group company if it's a QC.
QC loss	A QC with a net loss can make a loss offset to another group company and it doesn't have to be a QC (eg, can be a close company).	A QC with a net loss can receive a subvention payment from another group company and it doesn't have to be a QC (eg, can be a close company).

FBT (fringe benefit tax)

If fringe benefits are provided to shareholder-employees, the expenditure incurred in providing those benefits is fully deductible, provided it meets the normal deductibility criteria and the company is liable for FBT. The benefit is non-assessable to the shareholder-employee.

If fringe benefits are provided to shareholders who aren't employees, the expenditure isn't deductible to the company and non-assessable to the shareholders, and the company isn't liable for FBT.

Fringe benefits may affect the tax deductibility of interest on money borrowed by the shareholders to purchase shares in the qualifying company (see page 29).

Part 8 – Taxing shareholders of a QC

Dividends received from a QC

When a shareholder receives a dividend from a qualifying company, they'll be advised what portion is taxable and what should be returned in their own income tax return.

Exempt dividends distributed to beneficiaries

Exempt dividends paid to trusts will retain their exempt status when passed through to beneficiaries.

Deductible interest on money borrowed to purchase shares

If a shareholder who isn't an employee, or any person associated with the shareholder, has borrowed money to purchase shares in a QC, the interest incurred isn't deductible to the extent of any taxable dividends (other than taxable bonus issues).

The amount of interest allowed as a deduction will be reduced by the value of any non-cash dividends (other than taxable bonus issues) the shareholder derives in that income year, eg, low-interest loans or the provision of a car.

Example

A shareholder has incurred interest of $10,000 and has been provided with a low-interest loan and use of a car with tax values of $3,000 and $5,000 respectively. The maximum deduction for interest would be $2,000.

If a non-cash dividend arises because a shareholder has been provided with property, the dividend is deemed to arise at the end of each quarter of the QC's income year. This matches the timing for receiving the benefit with the deduction for the interest.

These rules don't apply to shareholder-employees. If a shareholder-employee derives a non-cash benefit from a QC, the benefit will be subject to FBT and as such isn't a dividend. This means any interest deduction should not be reduced by the value of the non-cash benefit.

The rules around the deductibility of interest include non-cash dividends received by people associated with the shareholder.

Terms we use

Controlled foreign company (CFC)

A foreign company controlled by five or fewer New Zealand resident shareholders.

Effective interest

A shareholder's effective interest generally means their voting interest in the company. However, where a market value circumstance exists, the average of market value and voting interest must be taken.

Excluded option

Any option to acquire or dispose of a share in a company when any of the following points are possible.

- The directors don't know, and can't reasonably be expected to know, that the option has been granted.
- Neither the grantor nor their associate holds shares at the time the option is granted, unless the grantor is the company.
- The option is granted at arm's length.
- The option's exercise price equates to the market value of the share.
- The option relates to an excluded security.
- The option relates to a pre-budget security and the option was granted before 30 July 1991.

Excluded security

Any fixed-rate share or section FA 2 debenture that doesn't carry any decision-making rights, except to protect the holder.

Fixed-rate share

A share issued where the dividend is payable at a fixed rate and isn't issued with the purpose of avoiding income tax.

Flat-owning company

Flat-owning companies are not business companies - they're set up to own residential property. Shareholders in a flat-owning company are entitled to use or occupy the property.

Foreign company

Any company that:

- is not resident in New Zealand, or
- is resident in New Zealand but, under a double tax agreement, is treated as not being a resident for tax purposes.

Foreign investment fund (FIF)

A foreign entity in which a New Zealand resident has an interest that entitles them to derive income from the fund (eg, offshore unit trust or superannuation fund). For more information see *A guide to foreign investment funds and the fair dividend rate (IR461)*.

Grace period

Where the elections to have a company treated as a QC have been revoked, the company has a grace period in which to make new elections without losing its QC status.

Jointly and severally liable

This means each shareholder, beneficiary or trustee separately, and all the shareholders, beneficiaries or trustees jointly, can be held liable for any debt.

Look through

A test to determine the number of natural person shareholders in a company. If a company has another company as a shareholder, it is necessary in some instances to "look through" the second company to see who really owns the shares.

Market value circumstance

A market value circumstance exists in relation to QCs in any of the following situations.

- The company has debentures on issue to which section FA 2 applies (and that are not excluded securities or pre-budget securities).
- The company has any shares on issue where a third party guarantees dividend payment.
- There is an option, other than an excluded option, to acquire a share in the company.
- An arrangement exists with the purpose of defeating a provision that depends on measuring voting and market value interests.

Market value interest

A person's market value interest in a company is measured where a market value circumstance exists. At any time, a person's market value interest equals their share of the total market value of shares and options held in the company.

Nominee

Any person who is nominated by another person to hold anything on behalf of, or to the order of, that other person. They must be a natural person, a QC or a trustee of a trust.

Pre-budget security

A fixed-rate share or a section FA 2 debenture issued before 8pm on 30 July 1991 or issued pursuant to a binding contract entered into before that date, where the terms of the contract or security are not subsequently altered.

Qualifying company (QC)

A company that meets all of the requirements to be eligible as set out in sections HA 6 to HA 9, and whose shareholders and directors have elected for it to be a qualifying company.

Unit trust

Any scheme in which subscribers or contributors to the trust share in the income and gains from the trust's investments. For taxation purposes a unit trust is treated as a company.

Voting interest

This is intended to reflect a person's economic interest in a company. A person's voting interest at any time equals their percentage share of total shareholder decision-making rights carried by shares or options in that company.

Services you may need

0800 self-service numbers

This service is available to callers seven days a week except between 5am and 6am each day. Just make sure you have your IRD number ready when you call.

For access to your account-specific information, you'll need to be enrolled with voice ID or have a PIN. Registering for voice ID is easy and only takes a few minutes. Call 0800 257 843 to enrol.

Order forms and publications	0800 257 773
All other services	0800 257 777

When you call, just confirm what you want from the options given. If you need to talk with us, we'll re-direct your call to someone who can help you.

Need to speak with us?

Have your IRD number ready and call us on one of these numbers:

General tax, tax credits and refunds	0800 775 247
Employer enquiries	0800 377 772
General business tax	0800 377 774
Overdue returns and payments	0800 377 771

Our contact centres are open 8am to 8pm Monday to Friday, and 9am to 1pm Saturday. We record all calls. Our self-service lines are open at all times and offer a range of automated options, especially if you're enrolled with voice ID.

For more information go to **www.ird.govt.nz/contact-us**

Privacy

Meeting your tax obligations means giving us accurate information so we can assess your liabilities or your entitlements under the Acts we administer. We may charge penalties if you don't.

We may also exchange information about you with:

- some government agencies
- another country, if we have an information supply agreement with them
- Statistics New Zealand (for statistical purposes only).

If you ask for the personal information we hold about you, we'll give it to you and correct any errors, unless we have a lawful reason not to. Call us on 0800 775 247 for more information. For full details of our privacy policy go to **www.ird.govt.nz** (search keyword: privacy).

If you have a complaint about our service

We're committed to providing you with a quality service. If there's a problem, we'd like to know about it and have the chance to fix it.

For more information, go to **www.ird.govt.nz** (search keyword: complaints) or call us on 0800 274 138 between 8am and 5pm weekdays.

If you disagree with how we've assessed your tax, you may need to follow a formal disputes process. For more information, go to **www.ird.govt.nz** (search keyword: disputes).

New Zealand Government