Inland Revenue
Te Tari Taake

Notes

In the *Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill* introduced to Parliament on 6 April 2017 it is proposed to amend:

- s CD 15 (Tax credits linked to dividends) to confirm that a non-cash dividend includes any resident or non-resident withholding tax paid for that dividend; and
- s LB 3 (Tax credits for resident withholding tax) to confirm that, when determining tax withheld and paid, a person's resident passive income includes resident withholding income for a non-cash dividend.

This QWBA sets out the Commissioner's view that these amendments to the Income Tax Act 2007 confirm the existing treatment of resident and non-resident withholding tax as explained below.

QUESTION WE'VE BEEN ASKED QB 17/07

RESIDENT AND NON–RESIDENT WITHHOLDING TAXES: NON-CASH DIVIDENDS

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked (QWBA) is about ss RE 14 and RF 10.

Question

1. Does the income of a person receiving a non-cash dividend include any resident or non-resident withholding tax paid on the dividend?

Answer

2. Yes.

3. This means a recipient of a non-cash dividend has income comprising the amount of the non-cash dividend determined under s CD 38 and any resident or non-resident withholding tax paid for that dividend.

Explanation

4. This question arises because, unlike a cash dividend where tax is withheld from the dividend income, with a non-cash dividend withholding tax must be paid in addition to the dividend income.

Resident withholding tax

5. In certain situations, the Act requires a person who is paying a dividend to another person to withhold some of the payment and pay it to the Commissioner as resident withholding tax (RWT). The person receiving the payment can usually offset the RWT as a credit against their tax liability for the payment, and receive a refund of the RWT in certain circumstances.

6. For RWT to apply, the payment must be "resident passive income" as defined in the Act (also known as "resident withholding income" in earlier Acts). Relevantly, "resident passive income" includes dividends whether paid in money (cash

dividends) or not paid in money (non-cash dividends). Generally, any transfer of value by a company to a shareholder caused by the shareholder relationship is a dividend. A non-cash dividend is a dividend if it does not consist of an unconditional payment in money or a credit to the balance of a shareholder's current account (or similar account) with the company. Non cash dividends are considered to be "paid" (in terms of the RWT provisions), as the Act defines an "amount" as including "an amount in money's worth" and it defines "pay" as including where any "amount" is distributed or credited to a person, or otherwise dealt with in their interest.

7. One example of a non-cash dividend is an in-kind (or "in-specie") distribution where property of the company is transferred to a shareholder for no consideration. Another example of a non-cash dividend is a taxable bonus issue. A further example is where there is a deemed dividend under the Act, such as when company property (eg, a company car) has been provided for a shareholder's private use and insufficient consideration has been provided for that use. Generally, this is where the shareholder is not an employee.[1]

8. The amount of a non-cash dividend taken into account for the RWT rules is the market value of what the recipient receives less any consideration the recipient provides in return (see s CD 38).

9. With cash dividends, s RA 9 makes it clear the gross dividend including the RWT is income of the recipient. Section RA 9 states the recipient derives the RWT "for the purposes of the Act" in the same way they derive the underlying payment.

10. This QWBA confirms the Commissioner's view that the same result arises for non-cash dividends. That is, the recipient's income from a non-cash dividend includes the RWT paid for the dividend. However, this is not clearly stated in the Act. The lack of clarity has led to doubt over whether a non-cash dividend is "grossed up" to include RWT.

11. Practically, it is not possible to withhold RWT from non-cash dividends as they are not paid in money. This means RWT cannot be "withheld" using the same legislative approach used for cash dividends. The Act must provide separately for RWT on non-cash dividends. It does so principally through s RE 14.[2]

12. Section RE 14 requires a person paying a non-cash dividend to calculate and pay RWT using a formula based on the "amount" of the non-cash dividend (as per s CD 38). In this situation, unless the Act treats the RWT as the recipient's income, their income would be limited to the amount of the non-cash dividend as determined under s CD 38.

13. Although s RE 14(4) treats the RWT "as if it were the amount of tax required to be withheld and paid under the RWT rules", this is only for the calculation in s RE 14(2). Section RE 14 does not treat the RWT calculated under the provision as an amount of RWT withheld for all purposes of the Act.

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[1] Where the shareholder is also an employee, non-cash benefits like the provision of a vehicle will generally be a fringe benefit rather than a dividend. Section CX 17 allows companies to elect some non-cash benefits to be treated as dividends instead of fringe benefits. This option does not apply to "unclassified benefits" such as vehicle-related benefits or loans which are treated as fringe benefits.

[2] Non-cash dividends that are either "bonus issues in lieu" or "a share issued under a profit distribution plan" are dealt with in a similar way under s RE 15 and the conclusions in this QWBA apply equally to those types of non-cash dividends.

14. Because there is no amount "withheld", it is unclear whether s RA 9 (as discussed above in paragraph 9) applies to RWT calculated under s RE 14. No other provision matching s RA 9 applies to non-cash dividends. Also, subpart CD of the Act (income arising from equity) does not specifically refer to the RWT calculated under s RE 14 as income of the recipient.

15. Any lack of clarity has only arisen since the Income Tax Act 2007 replaced the Income Tax Act 2004. However, the provisions of the Income Tax Act 2007 are intended to have the same effect as the Income Tax Act 2004. Where there is any lack of clarity in the Income Tax Act 2007 it is appropriate to consider the corresponding provisions in the Income Tax Act 2004 (see s ZA 3(4) of the Income Tax Act 2007).

16. Under the Income Tax Act 2004 (and earlier income tax legislation), it was clear the recipient's income included any RWT paid on non-cash dividends. In those Acts, RWT payable on a non-cash dividend was deemed to be a deduction of RWT for all purposes of the Acts (see s 327C(2) of the Income Tax Act 1976 and ss NF 2(2) of the Income Tax Act 1994 and 2004). The Commissioner's view of the issue under the 1976 Act is illustrated by the example at page 15 of *Tax Information Bulletin* Vol 3, No 7 (April 1992) where the recipient of a non-cash dividend ("Co. A" in example 2) is stated to derive an amount of income that includes the RWT. There is no identified change to the former s NF 2(2) in the Income Tax Act 2007 (see schedule 51 of the Act).

17. In addition, an inappropriate result could arise if the RWT paid for a non-cash dividend is not an amount of "tax withheld" for all purposes of the Act. Then, a tax credit would not be allowed for the RWT. This is because under s LB 3(1) a person has a tax credit equal to the "tax withheld" and paid in relation to their resident passive income. If no tax credit was allowed the result could be double taxation. Double taxation is where the same person is taxed twice on the same income. An interpretation that results in double taxation should not be adopted unless it is beyond any doubt that it was intended (see *Canadian Eagle Oil Co Ltd v R* [1945] 2 All ER 499 (HL); *C of T v Luttrell* [1949] NZLR 823 (CA)).

18. For example, with a non-cash dividend of $100, RWT of $49.25 would be paid to the Commissioner on behalf of the recipient of the dividend. Despite this tax payment on their behalf, the recipient could pay tax again for the same dividend if they could not claim a tax credit.

19. An inappropriate result would also arise if RWT on a non-cash dividend was treated as an amount withheld for the purpose of the tax credit provisions but not for the purpose of calculating the recipient's income. In that case, a mismatch arises between the recipient's income and the tax credits that can be offset against tax payable on the dividend income. For example, the RWT on a $100 cash dividend is $33. The recipient's income is $100 and the tax credit available to them for the RWT is consistent with the RWT tax rate of 33%. In contrast, the RWT on a $100 non-cash dividend is $49.25. If the recipient's income was only $100, the tax credit available to them is inconsistent with the RWT tax rate. However, the tax credit is consistent with the 33% RWT tax rate if the recipient's income is $149.25 (ie, $149.25 @ 33% = $49.25).

20. Finally, the Act defines "resident passive income" as including both dividends and the RWT paid for them. Arguably, it follows that for the purposes of the Act, dividend income includes the RWT (whether deducted from, or paid in addition to, the dividend). With cash dividends or interest, RWT is paid out of the income. RWT paid for non-cash dividends is an additional payment and an additional transfer of value from the payer to the recipient. It is appropriate to treat this additional amount as income of the recipient and it is consistent with amendments

made by the *Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017* (ss 267–268) to allow non-cash and cash dividends paid together to be treated for RWT purposes as a single dividend. It also avoids the inappropriate results mentioned above.

Non-resident withholding tax

21. A similar issue to that discussed above for RWT arises for non-resident withholding tax (NRWT). As with RWT, in certain situations the Act requires a person who is paying a dividend to a person who is not a tax resident to withhold some of the payment and pay it to the Commissioner as NRWT. For this to occur, the payment must be "non-resident passive income" as defined in the Act (also known as "non-resident withholding income" in earlier Acts). As with "resident withholding tax", non-cash dividends can be "non-resident passive income".

22. Section RF 10 applies NRWT to non-cash dividends. The formula operates to gross up the dividend in the same way as the RWT formula in s RE 14. For example, a $100 non-cash dividend attracts $42.86 NRWT using a 30% tax rate (ie, the dividend is treated as equivalent to a $142.86 cash dividend).

23. Non-resident passive income comprising dividends is also "schedular income" (see paragraph (f) of the s YA 1 definition "schedular income" and s RF 2(3)(a)). A person's tax liability for schedular income is calculated separately from other income under s BC 7. Section RF 2(4) applies to dividends and provides that if the dividend recipient is a filing taxpayer, their schedular tax liability under s BC 7 for the dividend is "determined by the amount of tax required to be withheld" (ie, the tax liability equals the NRWT paid). This makes the NRWT a final tax on the dividend and effectively means the non-resident recipient's income has been assessed as including the NRWT (ie, $142.86 using the $100 non-cash dividend example above).

24. A "filing taxpayer" is essentially any person who is not a "non-filing taxpayer" (see s YA 1 definitions). A "non-filing taxpayer" includes a person who only derives non-resident passive income in the year. So a person who is a non-resident who only received dividend income will be a non-filing taxpayer. Section RB 3(2) provides a non-filing taxpayer's terminal tax is their schedular income tax liability calculated using the formula:

$$\text{amount of income} \times \text{tax rate.}$$

25. For this calculation to give the same amount of terminal tax liability as the NRWT paid, the "amount of income" must include the dividend plus the NRWT paid for the dividend. Accordingly, the Commissioner's view is that the "amount of income" in s RB 3(2) includes **any NRWT paid** for the dividend income. If this was not the case, a non-filing taxpayer's tax liability for a $100 non-cash dividend would be $30 despite the $42.86 NRWT paid. This would be a similar anomalous result as noted above with RWT if the withholding tax is not treated as income along with the dividend.

Example

26. As shown, for tax purposes the income of recipients of non-cash dividends varies according to whether the dividend is subject to withholding tax. Companies providing non-cash dividends may need to consider if this unequal outcome has any implications for non-tax related legislation. One approach may be to pay an additional compensating payment to equalise the distributions to shareholders.

Facts

A New Zealand resident company has four equal shareholders: three are New Zealand tax residents and one is not a tax resident. Two of the three New Zealand resident shareholders are exempt from RWT.

The company pays a non-cash dividend by distributing to its shareholders shares the company holds in another company. Each shareholder receives 100 shares with a current market value of $10 each. The shareholders provide no consideration to the company in return so the amount of the dividend paid is $1,000. No imputation credits are attached to the dividends.

RWT for the resident shareholders

Where an RWT liability arises, the formula in s RE 14(2) applies as follows:

(tax rate × dividend paid ÷ (1 – tax rate)) – tax paid or credit attached

(0.33 × $1,000 ÷ (1 – 0.33)) – 0 = $492.53

Where the dividend is subject to RWT, shareholders' income is $1,492.53 ($1,000 + $492.53).

Where the dividend is not subject to RWT, the shareholders' income is $1,000.

NRWT for the non-resident shareholder

Where a NRWT liability arises, the formula in s RF 10(2) applies as follows:

(rate A ÷ (1 – rate A) × dividend payment)[3]

Where:
rate A = 0.3 (the tax rate set out in s RF 8)
dividend payment = $1,000 (the amount of the dividend to the extent it is not fully imputed)

(0.3 ÷ (1-0.3) × $1,000) = $428.57

Comment

As this example shows, companies may need to consider the differing results arising for shareholders when deciding to pay non-cash dividends. In this case, the company may wish to consider whether to make compensating payments to equalise the distributions to shareholders.

Comparison with cash dividends

In comparison, if the dividend in this example was a cash dividend and RWT or NRWT applied, the withholding tax would be deducted from the cash payment to the shareholders (ie, no additional amount would be paid by the company on the shareholders' behalf as RWT or NRWT).

[3] This is the formula following amendment by s 277 of the *Taxation (Annual Rates for 2016-17, Closely Held Companies and Remedial Matters)* Act 2017.

This means the income of all shareholders is $1,000 regardless of whether RWT or NRWT applied to the dividend. Assuming the dividend is taxable to a shareholder, depending on whether withholding tax applied or not, a shareholder either receives an after-tax amount from the company or has to fund any tax due on that dividend themselves.

References

Subject references
Non-cash dividend
Non-resident withholding tax
Resident withholding tax
Schedular income

Legislative references
Income Tax Act 1976: s 327C(2)
Income Tax Act 1994: s NF 2(2)
Income Tax Act 2004: s NF 2(2)
Income Tax Act 2007 – ss BC 7, LB 3, CD 15, CD 38, CX 17, RA 9, RB 3, RE 14, RE 15, RF 2, RF 8, RF 10, YA 1

Case references
Canadian Eagle Oil Co Ltd v R [1945] 2 All ER 499 (HL)
C of T v Luttrell [1949] NZLR 823 (CA)

Other references
Tax Information Bulletin Vol 3, No 7 (April 1992):15