



KPMG
10 Customhouse Quay
PO Box 996
Wellington 6140
New Zealand
Telephone +64 4 816 4500
Fax +64 4 816 4600
Internet www.kpmg.com/nz

Mr Paul Fulton
Policy and Strategy
Inland Revenue
PO Box 2198
WELLINGTON
BY email: Paul.Fulton@ird.govt.nz

Our ref ACDA
response.docx

18 December 2020

Dear Paul,

Available capital distribution amount: special rules for liquidations and share for share exchanges

Thank you for the opportunity to comment on the proposals in your letter of 13 November 2020.

You will appreciate that the deadline for responses is tight and is competing with many other policy and operational issues. We have not had the time to consider the proposal in detail. However, we have arrived at in principle solutions which we consider are worth exploring further.

There are broadly three issues raised in the letter. These are:

- Issue 1: the potential for double counting of capital gains (and converting revenue reserves to capital gain amounts) in the current available capital distribution amount (“ACDA”);
- Issue 2: share for share exchange available subscribed capital (“ASC”) rules can convert capital gains to revenue reserves;
- Issue 3: a revenue account property shareholder company can access capital gains of a subsidiary.

Issue 1 and 3

In principle

We see merit in addressing the first and third issues by having ACDA calculated at the parent level, i.e. there is no flow through.

Our recall of the need for the flow through rules is there was a risk that a gain made on a liquidation of a company would be a tainted capital gain. The flow

through rules addressed that by deeming a gain which took priority over any actual gain made by the shareholder.

As the tainted capital gain rules have been amended, it is arguable (but preferably it may be better to put it beyond doubt legislatively) that a liquidation gain would not be tainted. The shareholder would no longer have the asset (the shares) from which the gain is made.

This change to the tainting rules provides a significant simplification opportunity – to allow gains to be tested at the parent level only.

This would seem to address both issue 1 and 3 as there would be no opportunity to double count or for a capital gain to arise for a revenue account property shareholder.

Further work

We assume that any dividend paid on liquidation would not be included in the parent's ACDA calculation. This needs to be tested.

Further, we have not fully explored the consequences of this approach for different scenarios to determine whether there are any unexpected outcomes. This should be done as in our view this approach is much simpler than the proposed deeming rules.

Issue 2

We have not fully worked through the examples and scenarios. However, a much simpler solution would be to adjust the available ASC in a share for share exchange. In outline, it would work as follows:

- Consideration for the shares acquired less
- Revenue reserves of the target company
- Less cash and debt paid for the target shares
- Equals ASC for the shares issued.

This solution appears to deal with both implicit and explicit capital gains from the target company. Further, if the parent company solution for issue 1 is adopted, there should be no double counting of gains.

We note that this means the return of capital, rather, than the liquidation, rules would apply. However, that appears to be an appropriate trade off when New Zealand continues to not have a comprehensive capital gains tax.

We also understand that this proposal would need to consider whether a specific anti-avoidance rule is required.

ASC and ACDA memorandum accounts

The letter states there is no current intention to require memorandum accounts for ASC and ACDA. The concern with the current rules is that it is not until there is a liquidation or distribution that ASC and ACDA need to be confirmed. This creates evidence problems as there may be a significant period between ASC/ACDA being generated and it being used.



We submit that it is timely to introduce memorandum account rules. These should have a statute bar applied for credits to the memorandum account to provide taxpayers with certainty.

A memorandum account filed each year would also provide useful information to Inland Revenue. It would directly advise Inland Revenue of an amount treated as a non-taxable capital gain for example which may not be obvious from the tax return.

We acknowledge that the rules for the opening balance require some consideration. Any issues may be addressed by allowing both taxpayers and Inland Revenue an extended time to amend the balance. It is also likely that the level of evidence required should be modified. For example, an issue of shares at a consideration should be sufficient to establish ASC.

Policy principle

The current rules provide different tax outcomes depending on which company in the structure is sold. We consider the tax rules should apply to produce the same tax outcome whichever company is sold.

We have not tested our proposals against this principle. That should be done.

General

We trust that this response, albeit short, is clear and of assistance. We would be pleased to discuss it further. Please contact John Cantin on 04 816 4518 in the first instance if you have any questions.

Yours sincerely

John Cantin
Partner

Rob Hill
Partner