

Recent Developments in New Zealand International Taxation

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- FIF regime – changed from 1/4/07 (portfolio investment only)
- CFC regime – proposed to change from 1/4/09
- Mutual recognition – NZ Government is preparing a submission to the Australian Review Panel
- Treaty negotiations with Australia and US

FIF regime

- Grey list (of 8) meant non-professional investors generally only paid tax on dividends
- Fund managers paid full tax on dividends and gains (unless index-tracker)
- Regime
 - discouraged investment outside the grey list (subject to full tax on gains as accrued)
 - discouraged active professional management
 - encouraged investment in grey list funds – eg Australian unit trusts and UK authorised unit trusts – rather than NZ funds

New FIF regime (portfolio only)

- Grey list abolished (except Aussie listed)
- FDR method introduced. Deemed income = 5% of opening market value each year
- Natural persons and family trusts can pay tax using CV method instead, but losses not allowed
- CV method has to be applied to shares equivalent to NZ\$ debt
- FTC still available for withholding tax on divs
- No interest deductibility limitations

Effect of new FIF regime

- Some confusion over the FDR calculations, and what companies are eligible for the Aussie listed exemption
- Lots of rulings from IRD re whether investments qualify for FDR rather than CV
- Some structured products to take advantage of the deemed rate – eg Macquarie Reflexions
- Reaction from fund managers generally positive

Current CFC regime

- No tax on attributed income or dividends from grey list CFCs
- Full tax on attributed income and dividends from CFCs outside the grey list, with a credit for underlying foreign tax
- Conduit tax relief (CTR) eliminates tax to the extent of foreign ownership (but NRWT still imposed when earnings expatriated)
- No interest allocation rules (fat cap) except in certain cases when CTR is claimed

CFC Proposals

- Abolish the grey list for CFCs except for Australia
- Introduce an active/passive exemption – only passive and base company income is attributed to NZ shareholders
- De minimis rule – no attribution required if passive income is less than 5% of total income (can be measured using financial accounts (§EX 21C and §EX 21E))
- Dividends tax exempt to NZ companies (with exceptions)
- Interest allocation rules
- Remove CTR
- No change to taxation of non-portfolio FIFs

Non-attributing Australian CFC

- Resident in Australia
- Subject under Australian law to income tax on income
- Not treated as resident in a country other than Australia under a DTA
- Liability not reduced by
 - exemption for tax from business activities carried on outside Australia
 - OBU concession

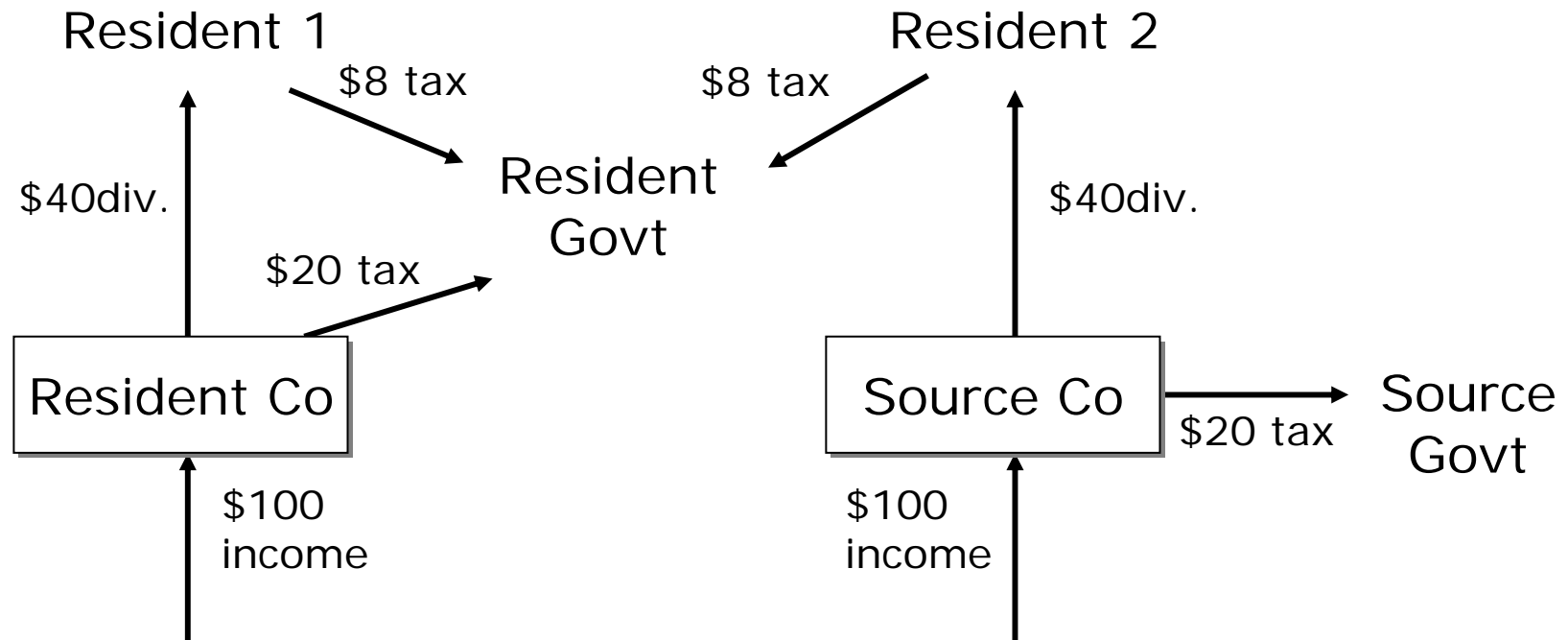
Other aspects of CFC proposals

- Definition of passive and base company income has been narrowed, but is likely to be contentious
- Rules required to apportion expenses where attribution is required – different rules for interest expense

Trans-Tasman aspects of the corporate tax system

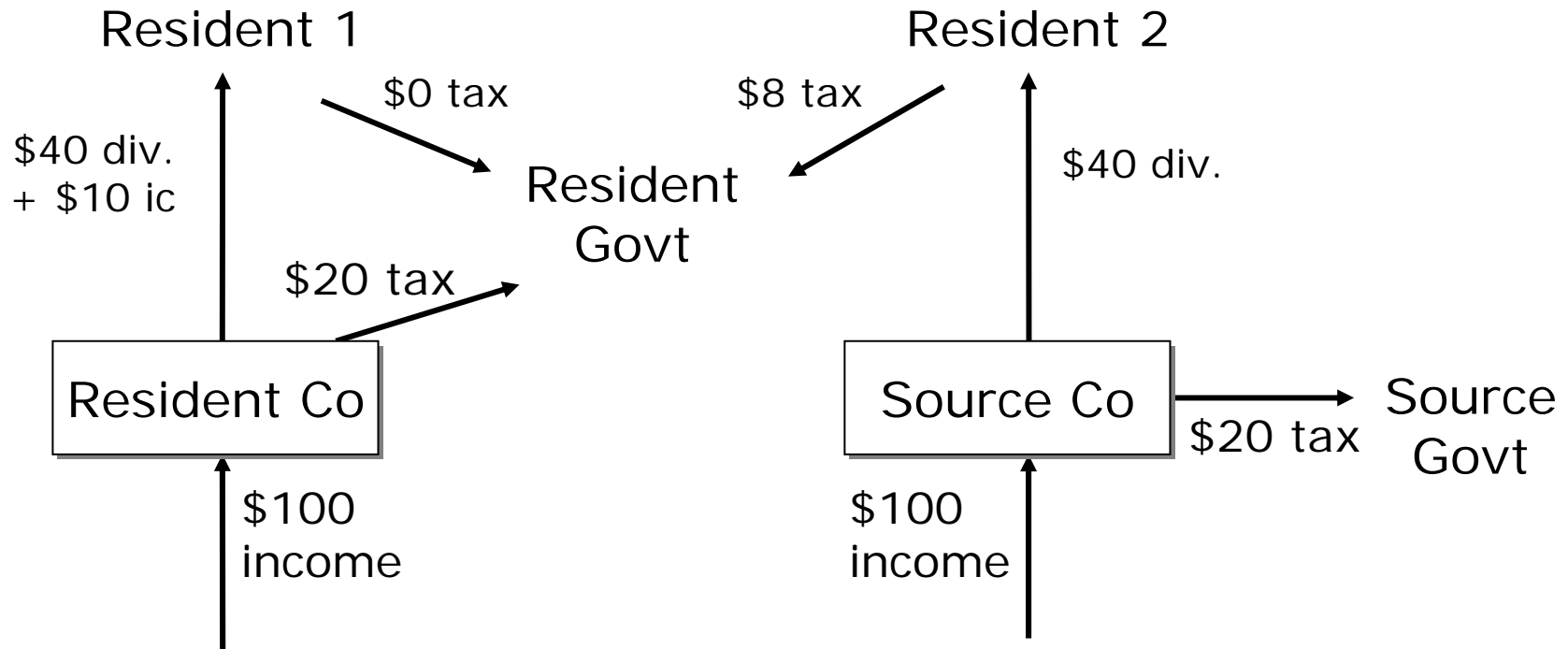
- Imputation creates a relative disadvantage for cross-border equity investment vs. domestic

Non-imputation



Note:
Investors have the same post tax return

Imputation



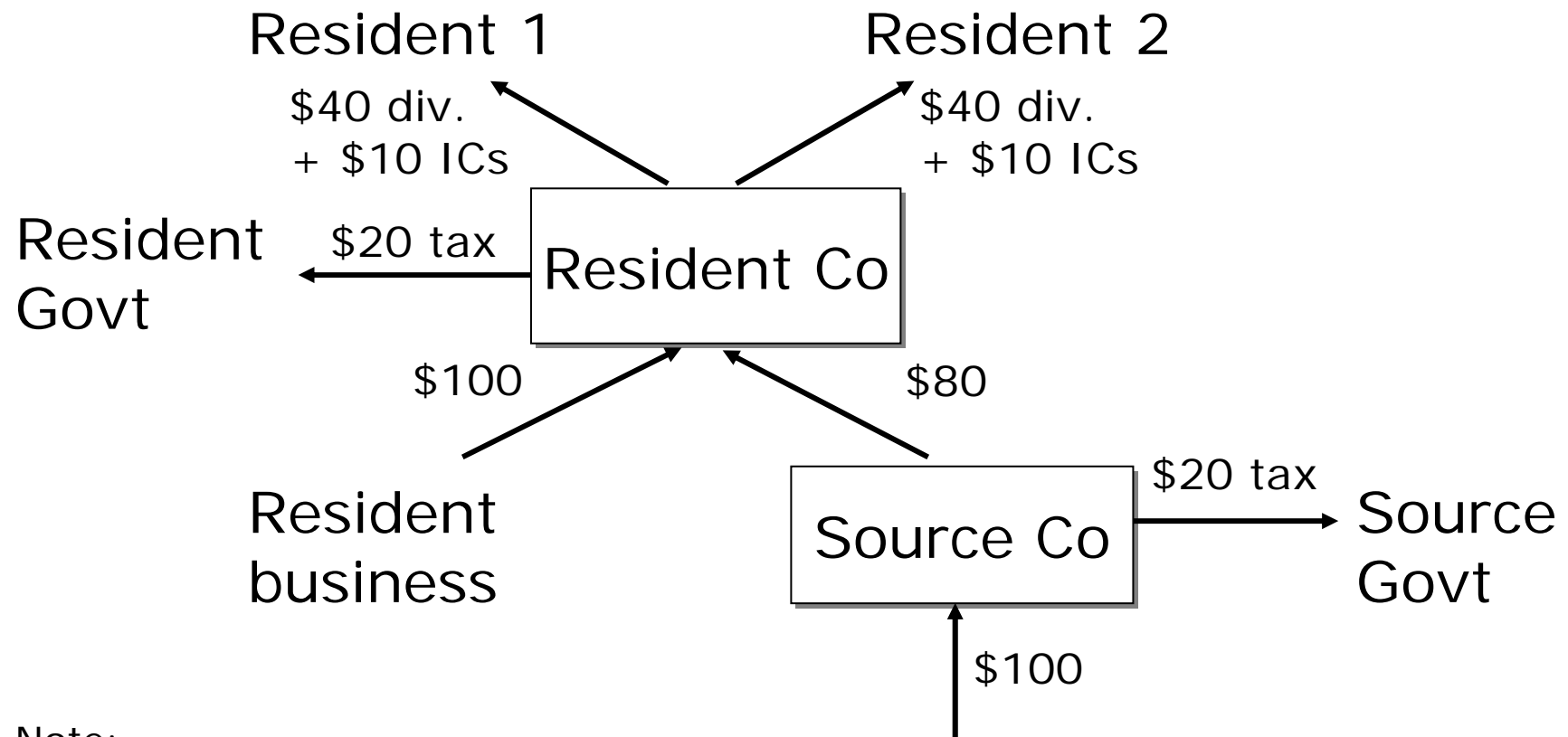
Is there a problem?

- Effect on resident companies seeking to expand abroad (NZ is a very small market)
- Effect on portfolio investment decisions (NZ investors are trapped in NZ share market – small and many sectors unrepresented, eg banks)
- Less Australian investment (because Australia has imputation too)

Solution 1

Undertake foreign investment in companies with domestic income

Solution 1 (cont)



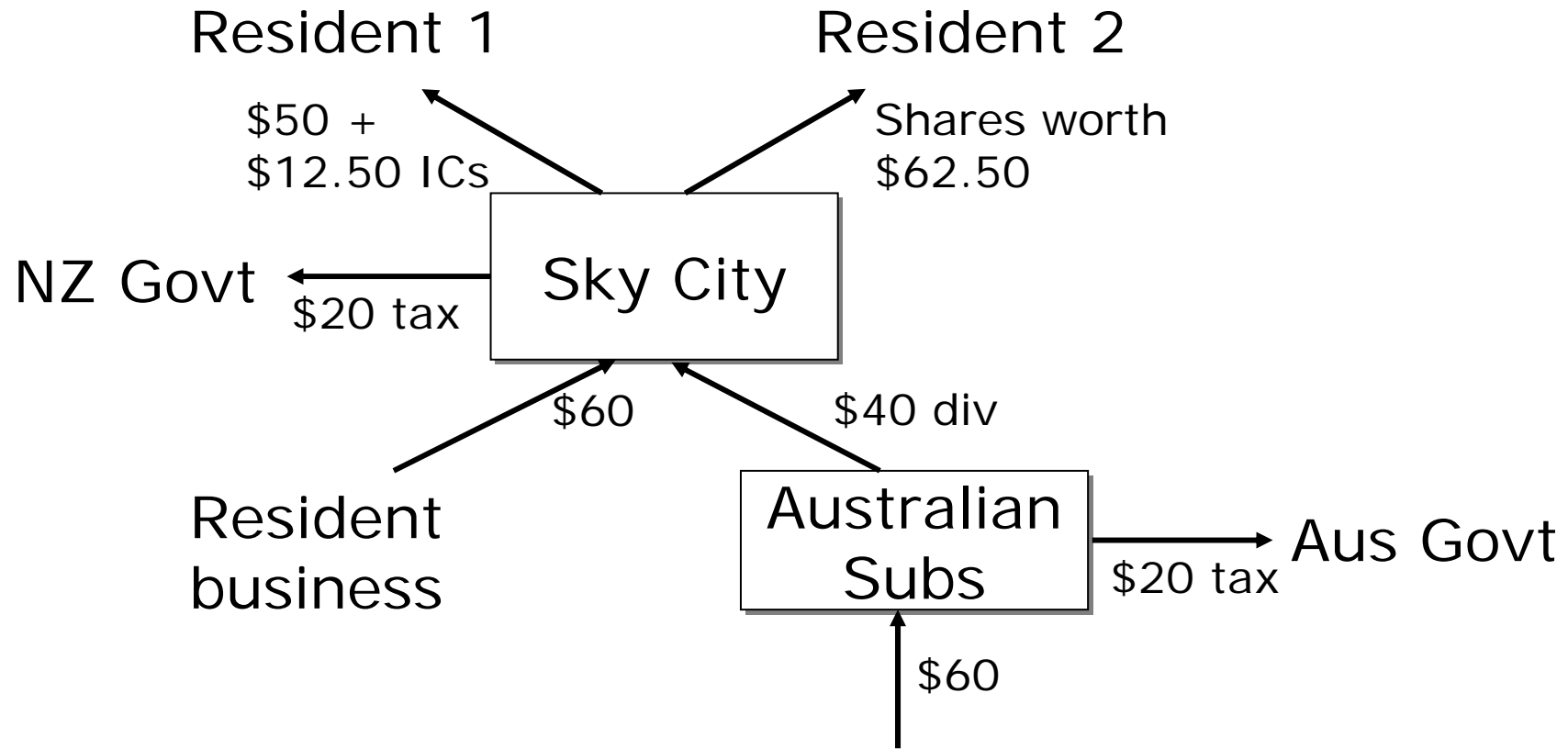
Note:

- Assumes dividend from Source Co is tax exempt
- Leaves unimputed earnings in Resident Co
- Relies on a favourable ratio between foreign earnings and distributions

Solution 2

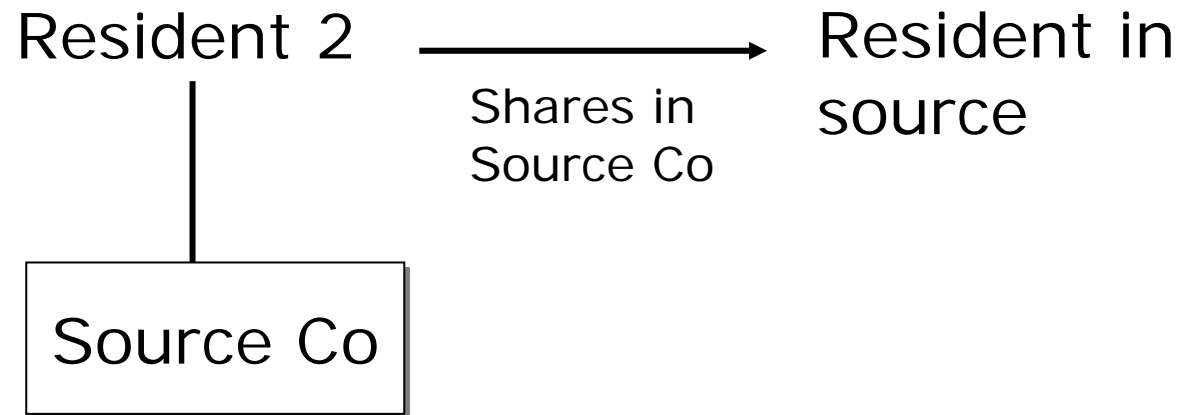
Reduce foreign taxes in favour of domestic
– eg transfer pricing and interest allocation

Solution 3 – Alternative Distribution Plan



Solution 4

Sell the shares (and reinvest in a domestic company)



Especially attractive if the source country resident can use the credits – eg if Australia is the source country

Solution 5

- (Government) lower the residence country tax rate on income from foreign companies
- Possibilities
 - Exempt foreign source dividends
 - Allow active foreign income exemption to pass out to domestic shareholders
 - Mutual recognition
 - Limited streaming
 - Abolish imputation

Mutual recognition

- What are the benefits?
- What are the costs?

For Australia and NZ, Governments,
investors, citizens

New Zealand

- Government will collect less revenue from Kiwis investing in Australian businesses
- Government will collect more revenue from Australians (more investment, and more willing to pay NZ tax)
- Economic benefits of increased FDI
- NZ residents able to make better investment decisions (tax less of a factor)
- BUT issues remain for ROW outbound investment

Australia

- Direct revenue foregone may be greater (more Aussie investment into NZ than vice versa) but it may be a smaller percentage of tax take (?)
- Less benefit from investment diversification, or attraction of NZ capital
- Concern re treaty (MFN) obligations (but no-one else has imputation)

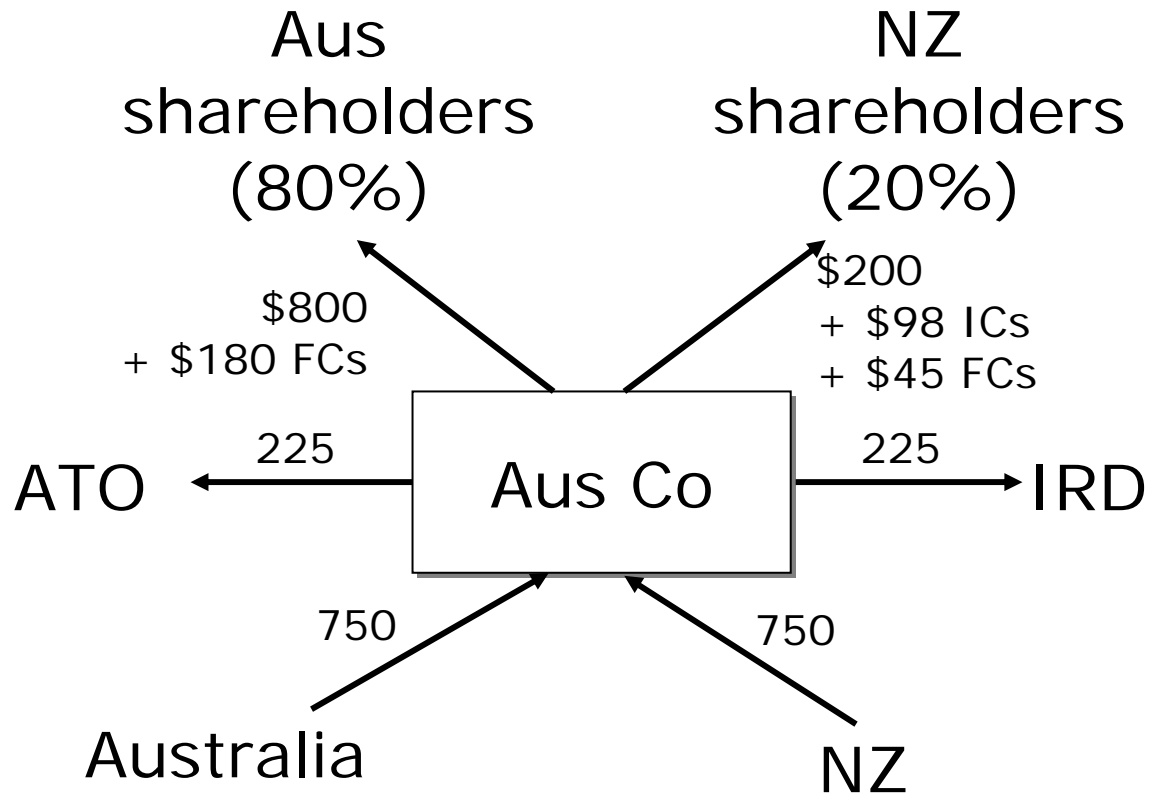
Mutual recognition – how?

- Imputation credits received by an Australian company treated as Australian tax paid (and vice versa)

OR

- Australian company keeps separate accounts for NZ and Australian credits, but under Australian rules (cf. triangular relief)
- Issues around
 - ring-fencing foreign tax credits
 - refundability of foreign tax credits
 - streaming rules

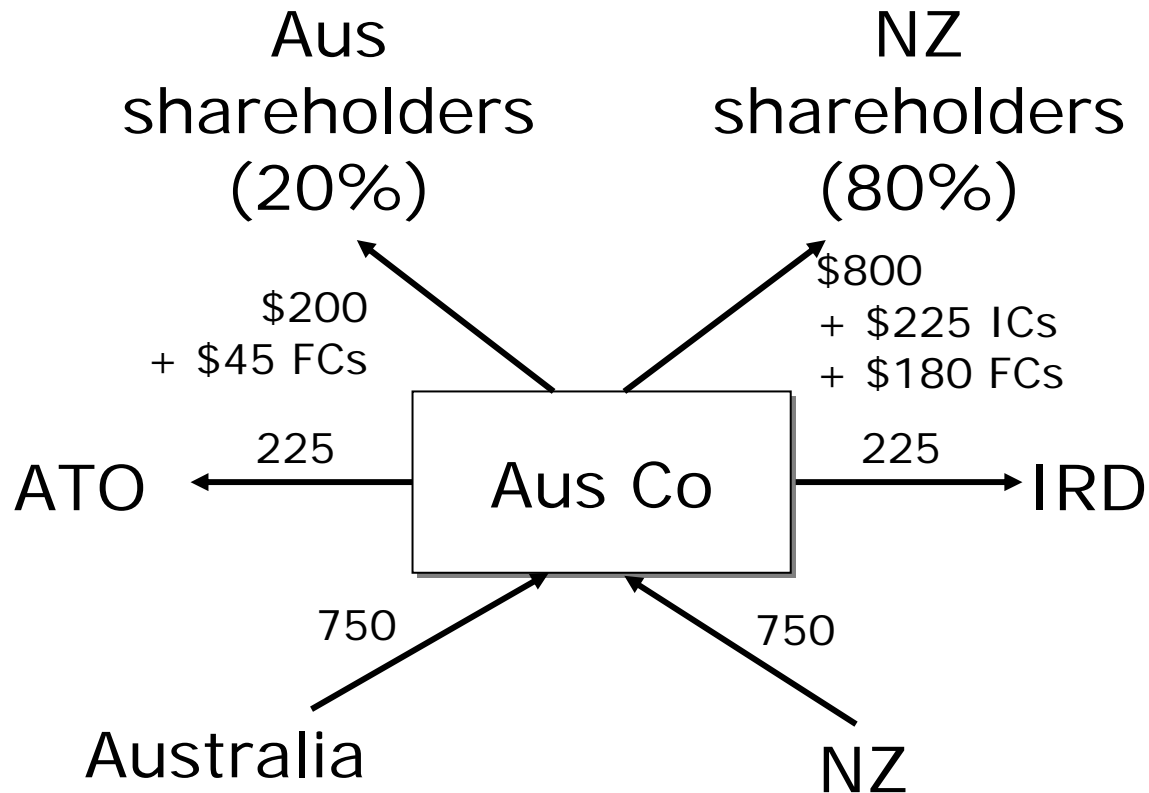
Limited streaming



Note:

(Hypothetical) NZ allows imputation credits to be streamed to NZ shareholders – Australia does not.

Limited streaming



Note:

Full tax has been paid but the dividend to NZ shareholders is no longer fully imputed.