Thin capitalisation

Part FG, Income Tax Act 1994

Introduction

A thin capitalisation regime has been introduced which will prevent non-residents from allocating an excessive proportion of their worldwide interest expenses against their gross New Zealand income.

The regime also acts as a backstop to the transfer pricing regime. Without the thin capitalisation regime, the benefits to the New Zealand tax base resulting from the transfer pricing regime would be offset by taxpayers' ability to shift profits from New Zealand using thin capitalisation techniques instead.

Background

The lighter tax treatment of debt compared to equity investment provides an incentive for non-residents to invest into New Zealand through debt rather than equity.

In conjunction with the other reforms in the Income Tax Act 1994 Amendment Act (No. 3) 1995 and the Tax Administration Amendment Act (No. 2) 1995, the thin capitalisation regime is consistent with the Government's "broad-base/low-rate" tax strategy. The thin capitalisation regime, together with the transfer pricing rules, is intended to help determine the amount of New Zealand-sourced income of non-resident investors.

Key features

- The regime is fundamentally designed to deny a deduction for interest if a non-resident allocates an excessive proportion of its worldwide debt to its New Zealand operations. An excessive allocation exists if a taxpayer's New Zealand group debt percentage exceeds 110% of the taxpayer's worldwide group debt percentage.
- The regime potentially applies to all of the following:
  - non-residents who derive New Zealand-sourced income
  - New Zealand companies controlled by a single non-resident person (together with persons associated with that person)
  - non-qualifying trusts that are 50% or more settled by a single non-resident person.
- For compliance cost reasons, a 75% safe harbour debt percentage has been introduced. Taxpayers with a consolidated New Zealand group debt percentage that does not exceed 75% will not be subject to the regime.
- A concession exists for on-lent funds. One effect of this is that financial intermediaries are effectively removed from the regime.

Application date

The thin capitalisation regime applies from the start of the 1996-97 income year.

Process for applying regime

A number of steps must be followed to determine whether the thin capitalisation regime applies to a taxpayer, and the extent to which it will apply. These steps are illustrated in the flow diagram on the following page. Note, however, that the flow diagram is indicative of the process, rather than exhaustive - space constraints dictate that the diagram cannot cover all possibilities.

The following analysis of the thin capitalisation regime follows the process outlined in the flow diagram, and provides further detail on specific aspects of the regime.

Application of the regime (section FG 2)

The regime can apply to three classes of taxpayers:

1. Taxpayers not resident in New Zealand

Non-resident taxpayers that operate a branch or fixed establishment in New Zealand will automatically be subject to the regime in relation to their New Zealand operations. This is to ensure that non-residents do not allocate an excessive portion of their worldwide interest expense to their New Zealand branch or permanent establishment.

However, there is one exception to this rule. If a single New Zealand resident holds a 50% or greater direct ownership interest in the non-resident, that non-resident will generally not be subject to the regime.

In practical terms, this means that first tier CFCs that are either operating a fixed establishment in New Zealand, or that are dually resident in New Zealand and another country or countries, will not be subject to the regime if they are controlled by a single New Zealand resident.

There is an exception to this exception. If another non-resident person holds a 50% or greater direct ownership interest in the first non-resident person (likely to arise only if that other non-resident is associated with the single New Zealand person), the first non-resident will remain subject to the thin capitalisation regime.

Non-resident individuals who derive income from New Zealand can also be subject to the thin capitalisation regime.

continued on page 15

Process for applying thin capi

Is the taxpayer any of the following?

- a non-resident (and not controlled by a single New Zealand re
- a New Zealand company controlled by a single non-resident
- a non-qualifying trust 50% or more settled by a single non-res

YES

Determine the taxpayer's New Zealand group

If taxpayer is a company, this involves determining the taxpaye parent, and that parent electing which companies will be meml taxpayer's New Zealand group.

Determine the taxpayer's New Zealand group debt percentage

A consolidation calculation needs to be performed to eliminate transactions from the balance sheets of individual group meml

Does the taxpayer's New Zealand group debt percentage

YES

from page 13

2. Companies resident in New Zealand and controlled by a single non-resident

This class of taxpayers is the one most likely to be affected by the regime. A New Zealand resident company will be subject to the regime if a single non-resident person either:

- holds a 50% or greater ownership interest in the company; or
- in conjunction with all persons associated with the single non-resident person, controls the company by any other means whatsoever.

The concept of an ownership interest is dealt with in detail in the next section. Essentially though, it is a test of whether control exists on a tier-by-tier basis down a chain of companies traced from the non-resident person to the relevant New Zealand company.

3. Non-qualifying trusts settled by a non-resident

A non-qualifying trust that is 50% or more settled by a person not resident in New Zealand will be subject to the regime. A trust will be treated as settled by a single non-resident person if the value of settlements made by that person, together with settlements made by persons associated with that person, total 50% or more of the total value of settlements made on the trust (section FG 2 (7)).

The discussion below focuses on the application of the regime to New Zealand companies, as it is anticipated that these persons will be the primary group affected by the regime. The application of the regime to trusts and individuals is dealt with at the end of the article.

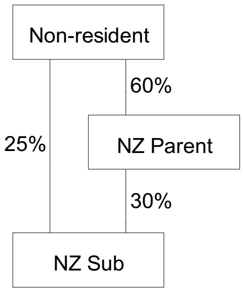
Control test (extent of person's "ownership interest")

The test of whether a company is controlled by a single person is contained in section FG 2 (2)-(6). The test is based on tier-by-tier control. Its essential argument is that if company A controls company B, and company B in turn controls company C, then company A will be held to also control company C by virtue of its ability to control company B.

Formally, control is said to exist when a person has an "ownership" interest in a company of 50% or greater. This ownership interest includes the person's direct and indirect ownership interests in the company, as well as direct and indirect interests held by persons associated with that person (section FG 2 (2)).

The following examples illustrate the direct and indirect interest concepts:

Example 1



Non-resident has:

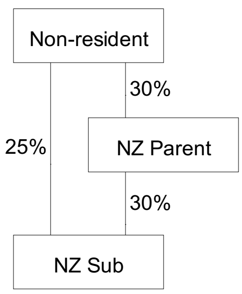
- a direct ownership interest in NZ Parent of 60%
- a direct ownership interest in NZ Sub of 25%.

However, because NZ Parent holds a direct ownership interest in NZ Sub, and Non-resident has a direct ownership interest in NZ Parent, Non-resident holds an indirect ownership interest in NZ Sub traced through NZ Parent. Because Non-resident is able to control NZ Parent (by virtue of an ownership interest at least equal to 50%), it is deemed to hold all interests held by NZ Parent in other companies (section FG 2 (4)(b)).

Non-resident's ownership interest in NZ Sub is therefore calculated as:

Direct ownership interest	25%
Indirect ownership interest	30%
Total ownership interest	55%

Example 2



The difference between this example and the previous one is that Non-resident now holds only a 30% direct ownership interest in NZ Parent. Assuming that no persons associated with Non-resident hold an ownership interest in NZ Parent, the indirect interest in NZ Sub is now calculated as 30% x 30% = 9% (section FG 2 (4)(a))

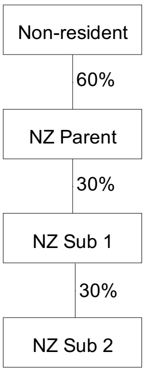
Non-resident's ownership interest in NZ Sub is calculated as:

Direct ownership interest	25%
Indirect ownership interest	9%
Total ownership interest	34%

continued on page 16

from page 15

Example 3

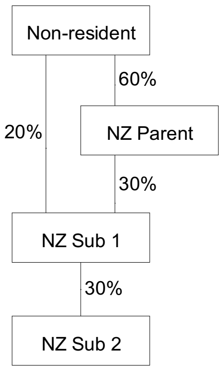


In this example, Non-resident holds:

- a 60% direct ownership interest in NZ Parent
- a 30% indirect ownership interest in NZ Sub 1
- a 9% indirect ownership interest in NZ Sub 2.

The indirect ownership interest in NZ Sub 2 arises because Non-resident holds a direct ownership interest in NZ Parent, and NZ Parent holds an ownership interest in NZ Sub 2 (there is no requirement that the ownership interest held by NZ Parent be a direct ownership interest for the tracing rule to apply).

Example 4



In this example, Non-resident holds an ownership interest in NZ Sub 2 of 30%. This arises because:

- Non-resident holds a direct ownership interest in NZ Sub 1.
- Non-resident's direct ownership interest in NZ Sub 1, when aggregated with direct ownership interests held by persons associated with Non-resident (NZ Parent) is 50%.
- Non-resident is therefore deemed to hold all ownership interests held by NZ Sub 1 in any other companies.

Note: Ordinarily, Non-resident would also hold an additional 9% indirect ownership interest in NZ Sub 2 traced through its direct ownership interest in NZ Parent. However, because this would result in the double counting of the same ownership interest, the ownership interest is only counted once (section FG 2 (5)).

Section FG 2 (3)

A person's direct ownership interest in a company is the highest interest held in any of the categories of income interest applied under the CFC regime. Thus, if a person directly holds 75% of the voting rights relating to distributions by the company, but only 60% of the total shares of a company and rights to vote in any other matters, the person's direct ownership interest in the company will be 75%.

Implications for taxpayers meeting conditions in section FG 2

If a taxpayer meets any of the criteria in section FG 2 (1), it will be necessary for the taxpayer to calculate its New Zealand group debt percentage. This is a consolidated calculation for all members of that taxpayer's New Zealand group.

Once the New Zealand group debt percentage of the taxpayer is determined, it is compared to these two threshold debt percentages:

- a 75% safe harbour debt percentage
- 110% of the worldwide group debt percentage of the taxpayer.

Both of these threshold debt percentages must be exceeded before the regime will apply to a taxpayer.

Safe harbour debt percentage

The purpose of the thin capitalisation regime is to deny a deduction for interest to the extent that the taxpayer's non-resident parent has over-allocated interest expense to New Zealand, compared with the debt percentage of its worldwide group. To this end, an interest deduction will be disallowed to the extent that the New Zealand group debt percentage of a taxpayer exceeds 110% of the taxpayer's worldwide group debt percentage (section FG 3 (b)).

For compliance cost reasons a 75% safe harbour debt percentage has also been included. This safe harbour is intended to ensure that most normal commercial structures will not be subject to the regime. Further flexibility has been provided by two additional features of the regime. In calculating a taxpayer's NZ group percentage:

- Interest-free debt will be treated as equity (section FG 4 (2)).
- A concession exists for funds on-lent by taxpayers (section FG 6).

Inland Revenue envisages that for most taxpayers, existing financial statements or tax accounts will make it quite easy to demonstrate that the 75% safe harbour debt percentage will not be breached by the taxpayer's New Zealand group, without the need for the formal NZ group consolidation calculations in section FG 4 to be performed.

New Zealand group debt percentage

There are two aspects to determining a taxpayer's New Zealand group debt percentage. First, it is necessary to determine which taxpayers will be members of the taxpayer's New Zealand group. This involves determining the New Zealand parent of the taxpayer, and that New Zealand parent then determining the group members.

Once the New Zealand group is determined, the generally accepted accounting principles (GAAP) of consolidation for the elimination of intra-group transactions are applied to the group to calculate the New Zealand group debt percentage of the taxpayer.

New Zealand group (section FG 4 (10)-(13))

The definition of a New Zealand group is built around three fundamental concepts:

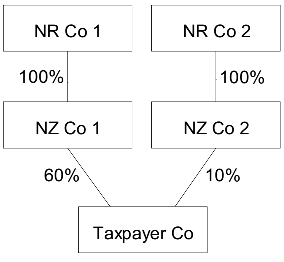
- The group will contain those companies for which control can be traced on a tier-by-tier basis from the taxpayer's New Zealand parent company.
- At the election of the New Zealand parent company, the threshold for tier-by-tier control will be based on either GAAP (greater than 50% control) or an alternative 66% threshold.
- The New Zealand group will be consistent for all companies in that group (if, in relation to any taxpayer, Co A is in the same New Zealand group as Co B, the New Zealand group for Co A will be the same New Zealand group that applies for Co B).

It is this last requirement for consistency between members of the New Zealand group that has resulted in the detailed rules in section FG 4 (10) and (11) to determine the taxpayer's New Zealand parent. The New Zealand parent is identified in relation to a number of taxpayers, and is required to make consistent grouping elections for all companies for which it is the New Zealand parent (section FG 4 (13)).

New Zealand parent

A taxpayer's New Zealand parent will be the top tier company resident in New Zealand which holds an ownership interest in the taxpayer. A top tier company is one in which non-residents hold a 50% or greater direct ownership interest. If more than one top tier company is identified, the New Zealand parent will be the one for which the direct ownership interests held by non-residents multiplied by the top tier company's ownership interest in the taxpayer produces the highest value (section FG 4 (10)).

Example 5



In the diagram, both NZ Co 1 and NZ Co 2 meet the conditions of section FG 4 (10)(b) to be the New Zealand parent of Taxpayer Co. Both companies hold an ownership interest in Taxpayer Co, and non-residents hold a direct ownership interest in each of the companies.

Under the tie-breaker rule in section FG 4 (10)(c), the New Zealand parent of Taxpayer Co will be NZ Co 1. This is because the direct ownership interests held by non-residents in NZ Co 1 (100%), multiplied by NZ Co 1's ownership interest in Taxpayer Co (60%) produces a greater result than multiplying the direct ownership interests held by non-residents in NZ Co 2 (100%), by NZ Co 2's ownership interest in Taxpayer Co (10%).

Election to vary New Zealand parent (section FG 4 (11))

The potential New Zealand parents identified by section FG 4 (10)(b) can mutually elect for the tie-breaker rule in section FG 4 (10)(c) not to apply. In that case, the New Zealand parent will be that company determined by joint election.

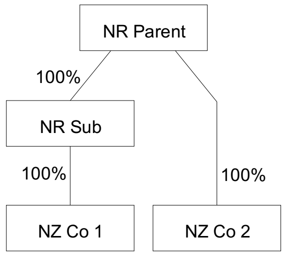
Determination of New Zealand group (section FG 4 (12))

The taxpayer's New Zealand group is determined once the taxpayer's New Zealand parent is identified. The group is defined in relation to the New Zealand parent.

The group will contain all companies which are either resident in New Zealand or are carrying on a business in New Zealand through a fixed establishment, and which are, at the election of the New Zealand parent:

- in the New Zealand parent's GAAP group; or
- in a group for which 66% aggregate direct ownership interests can be traced on a tier-by-tier basis from the New Zealand parent.

Example 6: GAAP group

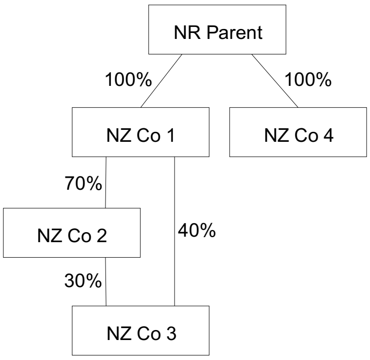


The GAAP group of NZ Co 1 will include NZ Co 2, as control of both companies can be traced on a tier-by-tier basis to NR Parent.

continued on page 18

from page 17

Example 7: 66% group



The 66% group of NZ Co 1 will consist of NZ Co 1, NZ Co 2 and NZ Co 3. NZ Co 2 is included by virtue of the 66% or greater direct ownership interest in the company held by NZ Co 1. NZ Co 3 is included by virtue of the fact that aggregate direct ownership interests of 66% or greater are held by members of a 66% group (NZ Co 1 and NZ Co 2).

Unlike the GAAP group, NZ Co 4 will not be a member of NZ Co 1's New Zealand group. NZ Co 4 will therefore form a New Zealand group by itself.

Calculation of New Zealand group debt percentage (section FG 4)

The taxpayer's New Zealand group debt percentage is calculated as the total debt of the taxpayer's New Zealand group divided by the New Zealand group's total assets. Section FG 4 provides specific rules for how the amount of these assets and debt are to be measured.

Requirement to consolidate

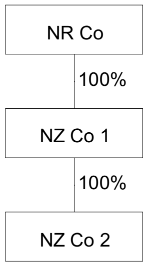
The taxpayer's New Zealand group debt percentage is determined by consolidating the assets and debt of the members of the taxpayer's New Zealand group to eliminate transactions between companies in that group. This consolidation is performed in accordance with the principles in SSAP-8 (section FG 4 (9)).

If the taxpayer's New Zealand group contains any member that is not resident in New Zealand, the assets and debt of that member will be included in the consolidated calculation for the group only to the extent that the non-resident is carrying on business in New Zealand through a fixed establishment (section FG 4 (17)).

The requirement to determine the taxpayer's New Zealand group debt percentage on a consolidated basis is necessary to maintain the integrity of the thin capitalisation regime. Without consolidation, it would be possible for non-residents to construct a chain of New Zealand companies, resulting in multiple counting of equity down the chain (equity in the top tier company would be used to provide the equity for the second company, and so on down the chain).

The following example illustrates how consolidation works.

Example 8: Consolidation



NR Co is a non-resident company, and NZ Co 1 and NZ Co 2 are resident in New Zealand.

Suppose that the balance sheets of NZ Co 1 and NZ Co 2 at 31 March 1997 read as follows:

NZ Co 1

Investment in NZ Co 2	100	Equity from NR Co	100
Other assets	300	Debt	300
	400		400

NZ Co 2

Assets	400	Equity from NZ Co 1	100
		Debt	300
	400		400

In isolation, it would appear that NZ Co 1 and NZ Co 2 each have a debt percentage of 75% and are therefore not subject to the thin capitalisation regime. However, the same $100 used by NR Co to provide equity for NZ Co 1 has also been used by NZ Co 1 to provide equity to NZ Co 2.

The consolidated accounts for NZ Co 1 and NZ Co 2 would read as follows:

Consolidated balance sheet

Assets	700	Equity from NR Co	100
		Debt	600
	700		700

Thus once the double counting of equity is eliminated through consolidation, the true debt percentage for the New Zealand group of 85.7% is determined. The New Zealand group may therefore be subject to the thin capitalisation regime.

The thin capitalisation regime may require taxpayers to calculate their group debt percentages for both of the following:

- New Zealand group (section FG 4)
- Worldwide group (section FG 5).

Measurement dates (section FG 4 (5)-(6))

The consolidation calculations can be performed, at the taxpayer's option, based on any of three alternative measurement bases:

- the last day of the taxpayer's income year
- an average of the amounts at the end of each three-month period in the year;
- an average of the amounts at the end of each day in the year.

If members of the taxpayer's New Zealand group do not all have the same balance date, these three alternatives apply as if the taxpayer had the same balance date as its parent (section FG 4 (6)).

Example 9: Different balance dates

A taxpayer has a 30 June 1997 balance date, but its New Zealand parent has a 30 September 1997 balance date. The alternative measurement bases are:

- 30 September 1997
- the average of the consolidated amounts on each of 31 December 1996, 31 March 1997, 30 June 1997, and 30 September 1997
- the average of every day in the period 1 October 1996 to 30 September 1997.

Measurement of asset values

Section FG 4 (4) provides the general rule that the measurement of the value of the assets for a taxpayer's New Zealand group is to be based on acceptable valuations under New Zealand's GAAP.

As a general rule, the valuation of assets will be the valuation recorded in the financial accounts for the New Zealand group (section FG 4 (3)(a)). However, it is recognised that the valuations for financial reporting purposes are likely to have been adopted for other than tax reasons. The regime therefore allows taxpayers to adopt some alternatives for valuing assets:

- If the taxpayer could have adopted the net current (market) value for assets under GAAP but has chosen not to for financial reporting purposes, the net current value may be adopted for thin capitalisation purposes.
- If market selling value has been adopted for tax purposes, those values may also be adopted for thin capitalisation purposes (this rule overrides the requirement that asset valuations be consistent with GAAP).

Definition of debt

The definition of debt under the thin capitalisation regime is based on the financial arrangement definition used under the accruals rules. A financial arrangement is treated as debt under the thin capitalisation regime if both of these conditions are met:

- The financial arrangement provides funds to the issuer.
- The issuer can claim a deduction in respect of the financial arrangement in calculating its assessable income (other than a deduction solely attributable to a movement in foreign exchange rates) (section FG 4 (2)).

The term "provides funds" is not defined in the Act. It is intended to convey the broad concept that only arrangements that provide capital to the issuer should be included in the thin capitalisation regime.

If there is any doubt over whether a particular financial arrangement provides funds, the new section 90A of the Tax Administration Act 1994 empowers the Commissioner to determine whether the financial arrangement provides funds for the purposes of the thin capitalisation regime.

Specified leases (section FG 9)

Specified leases are included within the ambit of the thin capitalisation regime. Accordingly, for the purposes of the regime:

- Debt will include specified leases.
- Deductible expenditure incurred under a specified lease will be treated as interest.

One implication of this is that specified leases will qualify for the on-lending concession.

On-lending concession (section FG 6)

There are rules that apply if any member of the taxpayer's New Zealand group is the holder of a financial arrangement which is issued by and provides funds to either of the following:

- a person who is not associated with the taxpayer
- a non-resident who also does not operate a fixed establishment in New Zealand.

In this situation, the amount of total assets and total debt of the taxpayer's New Zealand group are both reduced by the amount of the outstanding balance of that arrangement.

The term "outstanding balance" is not defined in the Act, but is a plain language English description of the accrued balance. Because the thin capitalisation regime generally relies on financial accounts (rather than tax accounts) to determine group debt percentages, the term has intentionally been left general in meaning.

The effect of the concession will be to effectively remove the activity of financial intermediation (e.g., banking) from the regime.

Example 10

A taxpayer's balance sheet at 31 March 1997 reads as follows:

Loan to unassociated non-resident	250	Equity	100
Other assets	150	Debt	300
	400		400

When consolidated calculations are performed for the taxpayer's New Zealand group, the amount of debt included in the calculation will be only $50, and the total assets taken into account will be $150. Both total assets and total debt are reduced by the amount of $250 qualifying for the on-lending concession.

continued on page 20

from page 19

Assets and debt denominated in foreign currencies

The value of assets and debt must be measured in New Zealand dollars. If the value of an asset or debt is denominated in a foreign currency, the taxpayer must convert the value of that asset or debt to New Zealand currency using either of the following:

- the close of trading spot exchange rate applying on the relevant measurement day (section FG 5 (6))
- the forward exchange rate applying on the first day of the income year for the relevant measurement day (section FG 7).

Anti-avoidance provision (section FG 4 (8))

Because of the potential for manipulating the amount of total assets and debt around a measurement date, the regime contains an anti-avoidance provision. Any temporary reduction in the amount of a financial arrangement or temporary increase in the value of an asset must be excluded from the calculation of the New Zealand group debt percentage if that reduction or increase has a purpose or effect of defeating the intent and application of the thin capitalisation regime.

This rule does not have the effect of requiring an adjustment to be made for temporary changes in the level of debt and assets that occur in the ordinary course of a taxpayer's business. To be caught by the anti-avoidance rule, there must be a purpose or effect to defeat the intent or application of the regime. Temporary changes that occur in the ordinary course of a taxpayer's business would be unlikely to have an attendant avoidance purpose or effect and would therefore not be caught.

Application of safe harbour debt percentage (section FG 3 (a))

Once the New Zealand group debt percentage of the taxpayer is determined, it is compared to the 75% safe harbour debt percentage. If the New Zealand group debt percentage is less than 75%, the thin capitalisation regime will not apply to the taxpayer.

If the New Zealand group debt percentage does exceed 75%, it is necessary to calculate the taxpayer's worldwide group debt percentage to determine whether the regime will apply.

Worldwide group (section FG 5 (8))

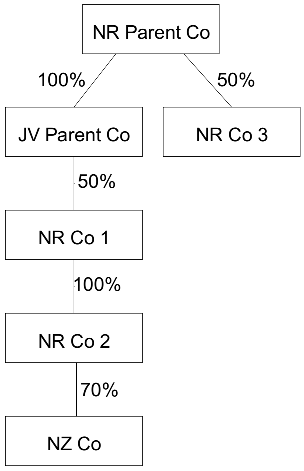
Broadly speaking, the taxpayer's worldwide group is based around the worldwide GAAP group of which the taxpayer is a member. However, if the top tier company of the taxpayer's worldwide GAAP group is 50% controlled by another company, the taxpayer's worldwide group will include that other company, as well as any other members of that other company's worldwide GAAP group.

The taxpayer's worldwide group includes the following companies:

- the taxpayer
- the taxpayer's New Zealand group
- the taxpayer's worldwide GAAP group
- the taxpayer's ultimate non-resident parent
- the worldwide GAAP group of the ultimate non-resident parent.

The following example illustrates this rule:

Example 11



The other interests in NR Co 1 are held by a number of unrelated parties.

In the diagram, NZ Co's worldwide group consists of:

- the taxpayer and its New Zealand group, being NZ Co only
- NZ Co's worldwide GAAP group, including NR Co 1 and NR Co 2
- NZ Co's ultimate non-resident parent, NR Parent Co
- NR Parent Co's worldwide GAAP group, including JV Parent Co.

Note that NR Co 3 will not be a member of NZ Co's worldwide group under this test.

Joint venture partners (section FG 5 (9))

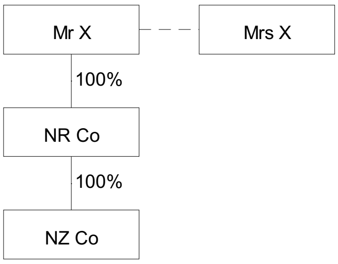
If, at some point in the chain, a company is controlled 50% by each of two joint venture partners, the taxpayer may elect to exclude one of those partners from its worldwide group. Members of that partner's worldwide GAAP group will also be excluded from the taxpayer's worldwide group if such an election is made.

Ultimate control by non-corporate

The taxpayer's worldwide group will also include any non-corporate person who holds a 50% or greater ownership interest in the taxpayer, together with persons associated with that non-corporate person.

The following example illustrates this rule:

Example 12



Because Mr X holds a 50% or greater ownership interest in NZ Co, he will be a member of NZ Co's worldwide group (section FG 5 (8)(e)). Any persons associated with Mr X (e.g., Mrs X) will also be members of NZ Co's worldwide group (section FG 5 (8)(f)).

The purpose of this rule is to prevent a non-corporate person thinly capitalising a non-resident company to circumvent New Zealand's thin capitalisation regime. If this were not prevented, the worldwide group debt percentage of the taxpayer could be made sufficiently high that any New Zealand group debt percentage would fall within the threshold debt percentage. This would make the thin capitalisation regime ineffectual.

Calculation of worldwide group debt percentage (section FG 5)

The calculation of the worldwide group debt percentage is similar to the calculation of the New Zealand group debt percentage. As with the New Zealand group debt percentage, the worldwide group debt percentage is calculated by applying GAAP principles of consolidation to the taxpayer's worldwide group to eliminate intra-group transactions (see page 5). There are, however, certain important differences.

The key differences are:

- The worldwide group debt percentage is generally calculated on the last day of the accounting year of the worldwide group ending most immediately before the income year of the taxpayer's New Zealand group.
- The amount of total debt and assets is calculated under a financial standard consistent with New Zealand's GAAP (debt will include non-interest bearing debt if it is included as debt in the worldwide group's financial accounts).

These differences are intended to reduce compliance costs. It is anticipated that the required details will generally be readily available in the existing financial statements of the taxpayer's worldwide group. However, for consistency with the determination of the taxpayer's New Zealand group debt percentage, the taxpayer may elect either or both that:

- debt for the worldwide group be measured based on the definition of debt used in calculating the taxpayer's New Zealand group debt percentage (i.e., financial arrangements that provide funds and are deductible);
- the total assets and debt of the worldwide group be calculated on the basis of the average daily or quarterly measurement bases able to be used to determine the taxpayer's New Zealand group debt percentage (section FG 5 (5)).

Consistencies with determination of New Zealand group debt percentage

The rules for determining the taxpayer's worldwide group debt percentage are very similar to the rules for determining the taxpayer's New Zealand group debt percentage in the following respects:

- The value of total assets and total debt is required to be denominated in New Zealand currency, and subject to the same exchange rate conversion rules (section FG 5 (6)).
- The amount of total assets and debt of the worldwide group must be reduced by any amount that is on-lent by a member of the group to a person not associated with the taxpayer and which provides funds to the recipient (section FG 6 (2)).
- An anti-avoidance rule applies so that any temporary increase in the amount of total debt or temporary decrease in the amount of total assets is disregarded in calculating the worldwide group debt percentage (section FG 5 (7)).

Default worldwide group debt percentage

If it is impractical or impossible for the taxpayer to determine the taxpayer's worldwide group debt percentage in accordance with the rules in section FG 5, the taxpayer may elect for the Commissioner to estimate it. The taxpayer's worldwide group debt percentage will then be the amount so estimated by the Commissioner.

If the Commissioner cannot reasonably make such an estimation, the taxpayer's worldwide group debt percentage will be treated as being 68.1818% (section FG 5 (12)). (The amount 68.1818% is used because that amount, when multiplied by 1.1, results in 75%, the safe harbour debt percentage.)

If the taxpayer is unable to determine its worldwide group debt percentage, and the Commissioner is not approached to estimate it, the taxpayer's worldwide group debt percentage will also be treated as being 68.1818%.

If there are no members of the taxpayer's worldwide group that are not resident in New Zealand, the taxpayer's worldwide group debt percentage will be treated as being 68.1818% (section FG 5 (13)).

Amount of interest expense denied a deduction (section FG 8)

The thin capitalisation regime will apply to deny an interest deduction if the taxpayer's New Zealand group debt percentage exceeds both of the following:

- 75%
- 110% of the taxpayer's worldwide group debt percentage.

continued on page 22

from page 21

In this situation the taxpayer's deductible interest expense for the income year will be reduced in accordance with the formula in section FG 8:

The amount of interest disallowed is calculated as:

$$(I - GI - IFD) \times \frac{TNZD - NZDA}{TNZD} \times \frac{NZDP - TDP}{NZDP}$$

In this formula:

I	is the amount which would have been deductible by the taxpayer under section DD 1 (b) but for this Subpart.
GI	is the amount deductible by the taxpayer under section DD 1 (b) in respect of amounts payable (excluding any amount included in item IFD) to a company included in the taxpayer's New Zealand group under section FG 4 (12) or section FG 4 (15).
IFD	is the amount deductible by the taxpayer under section DD 1 (b) in respect of financial arrangements excluded from total debt for the taxpayer's New Zealand group by virtue of section FG 4 (2).
TNZD	is the total debt of the taxpayer's New Zealand group, for the income year, calculated under section FG 4 before allowing for any adjustment under section FG 6.
NZDA	is the amount, if any, deducted under section FG 6 in calculating the total debt of the taxpayer's New Zealand group for the income year. (This amount must be averaged in circumstances where section FG 4 (5)(a) or section FG 4 (5)(b) applies.)
NZDP	is the taxpayer's New Zealand group debt percentage for the income year.

TDP is the greater of the following -

(a) 75 percent

(b) The taxpayer's worldwide group debt percentage multiplied by 1.1.

(Note: If the taxpayer is an individual who is not a trustee, TDP will always be 75 percent. This is discussed in the section on individuals below.)

The formula has three distinctive parts which achieve the following individual effects:

(I - GI - IFD)	is the amount of interest that would otherwise be deductible by the taxpayer under section DD 1 (b), less any amount of interest paid to another member of the taxpayer's New Zealand group or interest paid on any financial arrangement that does not provide funds to the taxpayer.
$\frac{TNZD - NZDA}{TNZD}$	is a deflator that reduces the amount of interest determined as (I - GI - IFD) proportionally to reflect the proportion of the taxpayer's New Zealand group's debt that is on-lent (and to which section FG 6 applies).
$\frac{NZDP - TDP}{NZDP}$	is a deflator applied to the amount of interest determined under the other parts of the formula which determines the proportion of affected interest to be denied a deduction. The basis for the calculation of this deflator is that, following the denial of an interest deduction, the amount of debt to which the remaining deductible interest applies will be the highest amount of debt in relation to the New Zealand group's assets for which no interest expense would be denied.

Elections (section FG 10)

There are a number of elections to be made under the thin capitalisation rules. In most cases, these are effected merely by completing a tax return that is consistent with the election made.

The only exceptions are if a taxpayer is required to make an election on behalf of another taxpayer (e.g., elections made by a taxpayer's New Zealand parent). In such cases, the election must be made in writing and submitted with the tax return of the person making the election.

Ability to revoke election and make new one

Section FG 10 (2) provides that a taxpayer may, on receipt of an assessment from the Commissioner, revoke an election to measure total assets and debts based on a single end of year measurement for the purposes of calculating the taxpayer's New Zealand and worldwide group debt percentages, and apply either the average of quarterly or daily values instead.

This provision is intended to apply if the taxpayer's calculation on the basis of a single measurement day indicated that the threshold debt percentages had not been breached, but a subsequent audit by Inland Revenue demonstrates otherwise. In this situation the provision allows the taxpayer to still determine the amount of interest expense to be disallowed based on an alternative measurement date basis, if the taxpayer so desires.

Application of regime to trusts

The application of the regime to trusts is very similar to the application of the regime to companies. The key differences are found in the definition of the New Zealand and worldwide groups of the trust:

- The New Zealand group of a trust includes all persons that are associated with the trust (section FG 4 (15)), and that meet either of the following conditions:
  - They are resident in New Zealand.
  - They are not resident in New Zealand, but are carrying on a business through a fixed establishment in New Zealand (but only to the extent those persons carry on business in New Zealand).

- The worldwide group of a trust includes all persons associated with the trust.

The principles of consolidation for determining the New Zealand and worldwide group debt percentages of the taxpayer apply in the same way as they do for groups of companies.

Application of regime to individuals

The thin capitalisation regime will apply to individuals (other than trustees) in a somewhat different manner from that of companies. This is necessary because:

- The requirement to consolidate assets and debts of associated relatives to determine New Zealand and worldwide group debt percentages is likely to be impractical.
- To simply remove the requirement to consolidate would undermine the application of the regime - real ownership would be difficult to determine if an individual's assets and liabilities became entangled with those of other family members.

The key differences in the treatment of individuals are as follows:

- Individuals are not required to calculate their New Zealand group debt percentage on a consolidated basis. Instead, the regime will focus only on their individual assets and liabilities (section FG 4 (16)(a)).
- Individuals are not able to benefit from the worldwide group debt percentage threshold. Instead, the regime will apply only on the basis of whether the 75% safe harbour threshold is exceeded (section FG 3).
- An individual's total assets will not include any private or domestic assets (section FG 4 (16)(b)).

Foreign investor tax credit regime

Part LE, Income Tax Act 1994

Introduction

The foreign investor tax credit (FITC) regime has been extended to all non-resident shareholders in New Zealand companies. The regime previously only applied to non-resident portfolio shareholders (less than 10% interest holders).

The effect of the FITC regime is to reduce the maximum rate of tax (combining company tax and NRWT) on non-resident equity investors to 33%, the same rate as for New Zealand companies.

The FITC regime allows a company an income tax credit (the FITC credit), which is calculated as a portion of the imputation credits attached to dividends paid to non-resident shareholders. The company is entitled to this credit when it pays a supplementary dividend of the same amount to its non-resident shareholders. Because it is based on the amount of imputation credit attached to a dividend, the FITC regime only applies to the extent that company tax has actually been paid.

The measures providing relief from double taxation for non-resident investors are mainly contained in new Part LE of the Income Tax Act 1994. Consequential amendments have also been made to the dividend and residual income tax definitions, and the resident withholding tax and imputation credit account provisions (sections OB 1, LD 3, ME 4 and ME 5).

Background

Previously, non-resident direct investors (those with 10% or greater interests) were taxed twice on income distributed from New Zealand companies. A New Zealand company paid tax at a rate of 33%. A further 15% was levied on dividends, in the form of NRWT, resulting in a total New Zealand tax impost of 43% on pre-tax income. For countries with which New Zealand has no double tax agreement the NRWT rate was 30%, and the total New Zealand tax impost was 53%.

In contrast, the total tax levied on New Zealand company income which is distributed to New Zealand shareholders does not exceed 33% because of the effect of the imputation system which prevents double taxation of New Zealand shareholders. The reason for the different treatment is that resident shareholders can use imputation credits to reduce tax on dividend income, but non-residents cannot.

A FITC credit has been allowed to companies paying supplementary dividends to non-resident portfolio shareholders (less than 10% interest holders) in respect of dividends paid on or after 28 September 1993.

Key features

- The regime applies to all non-residents with equity investments in New Zealand companies.
- The amount of FITC credit is based on the amount of imputation credit attached to a dividend. This means that the FITC regime can only apply to the extent that company tax has actually been paid.
- A portion of the underlying company tax is effectively refunded to non-resident investors, resulting in the total New Zealand tax (combining company tax and NRWT) on company income distributed to non-resident investors being limited to 33%.
- The refund of company tax is achieved by allowing New Zealand companies a tax credit, which they are entitled to when they pay a supplementary dividend of the same amount to non-resident investors. Non-resident investors remain liable for non-resident withholding tax (NRWT) on dividends (including

continued on page 24

from page 23

supplementary dividends) they derive from New Zealand resident companies (the NRWT rate is reduced from 30% to 15% to the extent dividends are fully imputed).

- The FITC credit is allowed against income tax payable by the company paying the supplementary dividend for the year in which the dividend is paid.
- If the company has paid no tax for that year, the FITC credit may be applied to refund tax paid in any of the four immediately preceding income years.
- If unutilised FITC credits still exist, the company can carry them forward, subject to shareholder continuity rules. Excess FITC credits are not refundable.
- A FITC credit received by a company can also be claimed against the tax liability of another company in the same wholly-owned group.
- Special rules apply to the application of the benchmark dividend and anti-credit streaming rules. The main effect of these is that the normal level of imputation credits attached to a dividend is reduced by an amount equal to the FITC credit.
- Specific statutory authority has been given to companies to pay supplementary dividends to ensure that there is no conflict with company law rules.
- The payment by a trustee of a fixed trust of a supplementary dividend to a non-resident beneficiary will not contravene any terms of the fixed trust.
- A special mechanism has been introduced to allow use of the FITC regime by lower tier New Zealand companies in circumstances where a New Zealand holding company has insufficient tax liability to utilise the FITC credit arising from paying a supplementary dividend to its non-resident investors.

Application date

The new FITC regime in Part LE applies with respect to dividends paid on or after 12 December 1995.

Availability of the tax credit (sections LE 2 (1) and OF 2)

The tax credit is available only:

- to the extent of imputation credits attached to dividends derived by non-resident investors from New Zealand resident companies (This is necessary to ensure that full company tax has been paid before the regime can apply.); and
- if the company has paid the non-resident investor a supplementary dividend equal to the amount of the FITC credit.

Only one supplementary dividend may be paid with each dividend. This is to prevent the FITC regime being used to reduce the total New Zealand tax imposed on income distributed to non-residents to less than 33%.

Although the supplementary dividend does not need to be paid by the company at the same time as the normal dividend, it does need to be paid in the same income year as the dividend to which it relates.

References to income years in the FITC provisions should be read as including non-standard accounting years (section OF 2).

Calculating the tax credit (section LE 2 (2))

The FITC regime reduces the tax which is charged on income earned by a company to the extent it is distributed to (and therefore attributable to) non-resident investors. The regime uses the imputation credits already allocated to dividends paid to non-resident investors (which were previously unusable) to calculate the value of the FITC credit received by the company. The company in turn passes these credits on to non-resident investors in the form of a supplementary dividend.

To take advantage of the FITC mechanism, a company must attach a different proportion of imputation credits to dividends paid to non-resident shareholders than it attaches to dividends paid to its resident shareholders. Section LE 2 (12) ensures that this treatment does not breach the anti-streaming rules in the imputation regime (see page 27).

Part LE determines the amount of FITC credit by reference to the amount of imputation credit actually allocated to the non-resident shareholder (as adjusted to take advantage of the FITC mechanism). The FITC credit is calculated by multiplying the amount of this imputation credit by the fraction 67/120 (equivalent to 0.5583 recurring). This means the credit is set at approximately 55.83 cents for every dollar of post-FITC adjusted imputation credits attached to dividends paid to non-resident investors. The FITC mechanism effectively reduces the underlying company tax rate so that the total New Zealand impost on company income distributed to non-resident investors is no more than 33%.

The amount of FITC credit a New Zealand company will receive can also be calculated directly by multiplying the imputation credits it would normally distribute on dividends paid to non-resident shareholders by the fraction 67/187, which is approximately equivalent to the constant 0.358275 (0.5583/1.5583). Thus if a company would have distributed $33 of imputation credit to its non-resident investors in the absence of the FITC relief, the credit would be $11.82 (67/187 x $33).

Table 1 on page 25 illustrates the calculations for a company that pays tax at 33% on $100 of profit which is fully distributed net of tax to shareholders. The table sets out the different treatments for a New Zealand investor, a non-resident direct investor before the extended FITC regime, and a non-resident direct investor under the new regime. In the last situation the total New Zealand tax take (combination of company tax and NRWT) is reduced to the level applying to New

Zealand shareholders (33%). Under the FITC regime the credit reduces the company's tax bill by $11.82. The dividend received by the non-resident investor is increased by the same amount (in the form of a supplementary dividend) from $67.00 to $78.82.

The $11.82 FITC credit is approximately equal to:

- 35.82% of the pre-FITC $33 of imputation credits

(continued in opposite column)

- 55.83% of the post-FITC $21.18 of imputation credits
- 15% of the post-FITC combined dividend and supplementary dividend of $78.82.

The supplementary dividend (which is equal to the FITC credit) of $11.82 is sufficient to pay the NRWT liability on the total dividend of $78.82. The NRWT rate is 15% (regardless of the non-resident investor's country of residence) as the dividend is fully imputed (section NG 2).

Table 1: Credit approach where dividends fully imputed

	New Zealand Investor		Foreign direct investor (previous)		Foreign direct investor (current)	
Profit before tax		100.00		100.00		100.00
normal company tax	(33.00)		(33.00)		(33.00)	
add back credit	0.00		0.00		11.82	
Net company tax		(33.00)		(33.00)		(21.18)
Profit after tax		67.00		67.00		78.82
Dividends		67.00		67.00		78.82
less personal tax (@ 33% of $100)	(33.00)		0.00		0.00	
add back imputation credits	33.00		0.00		0.00	
less NRWT (@ 15% of dividend)	0.00		(10.05)		(11.82)	
Net deductions		0.00		(10.05)		(11.82)
Net dividend to shareholder		67.00		56.95		67.00
Tax paid to New Zealand		33.00		43.05		33.00

Table 2 illustrates the effect of the new regime on the home tax treatment of non-resident investors. In particular, it shows that the FITC regime results in an increased tax take for the home country of the investor. (It is assumed that the home country imposes tax on the gross dividend, and allows a credit for New Zealand NRWT.)

Table 2: Credit approach - home tax treatment

	Foreign direct investor (previous)		Foreign direct investor (current)	
Profit before tax		100.00		100.00
less normal company tax	(33.00)		(33.00)	
add back credit	0.00		11.82	
Net Company Tax		(33.00)		(21.18)
Profit after tax		67.00		78.82
gross dividends	67.00		78.82	
less NRWT (@ 15% of dividend)	(10.05)		(11.82)	
Net dividends repatriated home		56.95		67.00
Tax paid to NZ		43.05		33.00
Net dividends		56.95		67.00
gross dividends	67.00		78.82	
home taxes (@ 33% of gross dividends)	(22.11)		(26.01)	
less foreign tax credits for New Zealand NRWT	10.05		11.82	
Net home tax liability		12.06		14.19
Net dividends		44.89		52.81

continued on page 26

from page 25

Utilisation of FITC credit (section LE 2 (4)-(10))

Section LE 2 contains a number of ordering rules for the utilisation of a FITC credit.

Summary

The FITC credit is calculated in respect of an income year in which a supplementary dividend is paid. The offset of the credit is made in the following order:

- First, against the taxpayer company's income tax payable for the income year in which the supplementary dividend is paid.
- Second, against either of the following:
  - the taxpayer company's income tax payable for the previous four income years
  - the income tax payable by another company in the same wholly-owned group as the taxpayer company for the year in which the supplementary dividend is paid or the four previous income years.
- Third, subject to the shareholder continuity requirements of subsection (7) being met, carried forward to a future income year and offset against the company's income tax liability for that future year. If the carried forward credit is not able to be offset against the company's own tax liability, the company may elect to offset the credit against the income tax liability for that future year of another company in the same wholly-owned group.

The order of offset is explicitly provided in section LE 2. The credit must be applied as far as possible under step one, with step two applying only to the amount of FITC credit not able to be utilised under step one, and step three applying only to the extent that the taxpayer cannot utilise the credit under steps one and two.

Options for offset in the current year

A company has two options for benefiting from the FITC credit applied to a current year tax liability. The company may either:

- reduce its terminal tax payment by the amount of the credit (this occurs automatically as the FITC credit reduces a company's residual income tax); or
- if paying provisional tax on the estimation basis, reduce its provisional tax by the amount of FITC credit it estimates it will have by the end of its income year. There is no requirement for a company to have paid any provisional tax before it pays a supplementary dividend. The supplementary dividend will give rise to a FITC credit, reducing its residual income tax which will flow through to lower provisional tax payments.

The use of money interest provisions in the Act will apply as normal for a current year FITC offset. The company's residual income tax (on which use of money interest is based) will be reduced by the amount of the FITC credit.

Effect of credit carry back (section LE 2 (6))

A FITC credit may need to be applied against the tax liability of a company for an earlier income year. This could occur if a company pays dividends with imputation credits but has no current year tax liability (because the imputation credits attached to the dividend paid in the current year relate to the taxable profits of prior years).

This situation is addressed by allowing the credit to be used to refund tax paid in any of the four immediately preceding income years. Only tax relating to the 1993-94 or later income years is refundable in this way. Note that the base year for the purposes of the carry-back of the FITC credits is the 1993-94 income year for both direct and portfolio non-resident investors.

If a company applies a FITC credit to an income year that is earlier than the one in which the relevant supplementary dividend is paid, use of money interest is not payable in relation to that credit and the earlier income year.

This is the correct policy result. The objective in applying the credit from the FITC mechanism to an earlier year is to provide a mechanism to reduce the total level of New Zealand tax on non-resident investors to 33%. The refund of any tax under this mechanism is the means of achieving this objective, rather than reflecting an over-assessment of tax for an earlier year. It is therefore not appropriate that a use of money interest credit arise in these circumstances, and the section OB 1 definition of "residual income tax" has been amended to ensure that use of money interest is not paid in relation to a refund of income tax resulting from such utilisation of a FITC credit arising from a supplementary dividend paid during the 1995-96 income year and subsequent years.

Effect of refund on imputation account

A refund of income tax resulting from the carry back of a FITC credit to an earlier income year than the year in which the supplementary dividend is paid will give rise to a debit in the company's imputation credit account (section ME 5 (1)(e)). A refund of tax resulting from the carry back of a FITC credit will always result in a debit to the company's imputation credit account, notwithstanding any previous shareholder continuity breach. (A refund relating to income tax paid before the date on which an ICA debit arises from a shareholder continuity breach normally does not give rise to a further ICA debit to the extent that the refund does not exceed the debit arising from the shareholder continuity breach.) (section ME 5 (1)(e)(iii)).

However, the Government has announced that a remedial amendment will be made to ensure that a debit does not arise for a FITC refund if the following sequence occurs:

1. a company pays a dividend in respect of which a supplementary dividend will be paid.
2. a shareholder continuity breach then occurs for which a debit arises to the imputation credit account of the company.
3. a refund of FITC in respect of the supplementary dividend is not received from Inland Revenue until after the shareholder continuity breach.

Credit carry forward (section LE 2 (7) and (8))

FITC credits that cannot be utilised in the current year or carried back to a previous income year can be carried forward to a subsequent year subject to shareholder continuity rules. This can occur only if a company is not able to offset the FITC credit against income tax payable by the company (or another company in the same wholly-owned group) in the income year that the company pays a supplementary dividend or an earlier income year.

The shareholder continuity rules applying for the purposes of the carry forward of FITC credits are similar to those applying for the purposes of the loss carry forward rules. There must be a group of persons whose aggregate minimum voting interests (or minimum market value interests if a market value circumstance exists) in the company in the period from the beginning of the income year in which the excess credit arises to the end of the year of carry forward is equal to or greater than 49%.

Application of credit mechanism to wholly-owned groups (section LE 2 (6) and (9))

Under the FITC regime the company paying the supplementary dividend to a non-resident investor is entitled to the tax credit. However, in a group of companies the parent company paying a supplementary dividend to a non-resident investor may have no tax liability of its own that it can offset the tax credit against, as the subsidiaries themselves pay the tax within the group.

This situation is addressed by allowing a FITC credit received by a company to be claimed against the tax liability of another company in the same wholly-owned group. For this to happen, the company that receives the tax credit must elect to do so by filing a written notice with its tax return for the relevant year.

The four-year credit carry back rule also applies to a wholly-owned group. A company may use a FITC credit it receives to reduce tax paid by another company in the same wholly-owned group in the four years preceding the income year in which the dividend is paid.

The FITC credit carry forward rule also applies to a wholly-owned group. If a FITC credit carried forward by a company cannot be utilised by the company itself, the credit may be used to reduce income tax payable in the year of carry forward by another company in the same wholly-owned group.

Priority of FITC as a tax credit (section LE 2 (3) and (8))

The credit for company tax available under the FITC regime is offset against income tax payable by a company after allowing for foreign tax credits available under section LC 1. If that were not the case, it is conceivable that a company might extinguish its New Zealand tax liability under the FITC regime, leaving no New Zealand tax liability against which it could offset any available foreign tax credits. Such credits are lost if they are not offset against New Zealand income tax payable on foreign income in the same income year that the foreign income is derived.

The credit for company tax available under this regime is offset against income tax payable by a company before allowing for imputation credits available under section LB 2 which are attached to dividends received by the company. This ordering rule allows a company deriving fully imputed dividend income to still utilise the tax credit available under the FITC regime. Such a company can convert resulting excess imputation credits into a loss which can in turn be offset against the income of other companies in the same group or carried forward by the company (subject to normal shareholder continuity requirements).

The FITC credit is also offset against income tax payable by a company before allowing for resident withholding tax credits available under section LD 3. This ordering rule is of benefit to companies receiving income from which resident withholding tax has been deducted, as excess resident withholding tax credits are refundable. Resident withholding tax credits are offset against income tax payable by a company after allowing for imputation credits (section LD 3 (3)).

Meaning of term “dividend” for FITC purposes

The term “dividend”, for the purposes of the FITC regime in new Part LE, includes the amount of any imputation credit attached to the cash dividend. This is achieved by the inclusion of a reference to Part LE in Section CF 6 (1) of the Income Tax Act. Section CF 6 (1) grosses up the amount of a dividend to include any imputation credits attached to it for the purposes of certain Parts of the Income Tax Act.

Application of benchmark dividend and anti-credit streaming rules (section LE 2 (11) and (12))

If a company receives a tax credit under the FITC regime, the company’s tax payments are reduced; this in turn reduces the amount of imputation credits available for distribution with dividends. It would defeat the purpose of the regime if this reduction in tax (and corresponding reduction in available imputation credits) combined with the benchmark dividend and anti-credit streaming rules to prevent companies from doing either of the following:

continued on page 28

from page 27

- distributing the normal amount of dividend with the normal amount of credits attached; or
- paying supplementary dividends.

To deal with this, companies are relieved from the benchmark dividend and anti-credit streaming provisions in the imputation and FDWP regimes in relation to the payment of supplementary dividends.

Section LE 2 (11) states that for the purposes of the benchmark dividend and anti-credit streaming rules of the imputation and FDWP regimes, the supplementary dividend is treated as if it were not paid. This means that the anti-credit streaming rules will not be breached, even though the supplementary dividend has no imputation credits attached.

Section LE 2 (12) provides also that for the purposes of these imputation regime rules, a company is deemed to have attached an imputation credit to the normal dividend it pays out equal to the amount of the FITC credit. This deeming provision is necessary to enable a company to attach different levels of imputation credits to its domestic and foreign shareholders without contravening the anti-credit streaming rules.

Just as importantly, the deeming provision also ensures that the benefit of the FITC credit that a company receives under the regime is passed on to its non-resident investors because otherwise there would be a breach of the imputation credit rules. A company that paid normal fully credited dividends to non-resident investors and a supplementary dividend would be deemed to have attached to the normal dividend additional imputation credits equal to the supplementary dividend. This would result in a breach of both section ME 8 (1) (the maximum imputation credit rule) and section ME 8 (2) (the benchmark dividend rule). To avoid such breaches the company would need to reduce the supplementary dividend to zero.

Only by reducing the level of normal imputation credits by the level of tax relief available (i.e., the FITC credit) can the imputation credit streaming rules be complied with. Therefore in the example in Table 1, the company may only attach $21.18 of imputation credits (not $33) to the dividend paid to the non-resident investor under the FITC regime. This is the right policy result because the tax relief itself reduces corporate tax and should therefore reduce the normal level of imputation credits.

Section ME 4 (1)(a)(v) provides that income tax paid by way of crediting under Part LE does not give rise to a credit in a company's imputation credit account.

Ability to pay supplementary dividends and company law requirements (section LE 2 (13))

The payment of a supplementary dividend by a company to a non-resident investor is specifically deemed not to contravene any of the following:

- any provision of the Companies Act 1955 or section 45 of the Companies Act 1993; or
- the company's articles of association or constitution; or
- any other rule of law.

This provision has been included for these reasons:

- It relieves companies of the need for and cost of changing their articles of association or constitutions to authorise the payment of a supplementary dividend to their non-resident shareholders.
- It overrides section 45 of the Companies Act 1993, which prohibits companies from having constitutions which permit differential dividends to be paid to shareholders of the same class.
- It removes any doubt that any provision of the Companies Act 1955 or any other rule of law could prevent companies from paying supplementary dividends even if their articles of association or constitutions specifically permit such payments.

A company may still insert a provision in its articles of association or constitution which prohibits the payment of a supplementary dividend, provided such provision expressly refers to section LE 2 (13) of the Income Tax Act 1994.

Interface with trusts (section LE 2 (14))

Non-resident beneficiaries of trusts will be able to benefit from the FITC regime in the normal manner if they derive dividends and supplementary dividends as beneficiary income from New Zealand resident companies in terms of section LE 2 (1).

Trustee shareholders will need to advise New Zealand resident companies of their non-resident beneficiaries who will derive any dividend as beneficiary income in the same manner as nominee companies currently advise companies of their non-resident investors. This is necessary so that companies can pay supplementary dividends along with normal dividends to the trustee shareholders who receive them on behalf of the non-resident beneficiaries. The trustee shareholders will then on-distribute the dividends to the non-resident beneficiaries who will derive such dividends as beneficiary income. Subject to this advice function being undertaken, the FITC regime should apply in the normal manner to trusts with non-resident beneficiaries.

Section LE 2 (14) is designed for fixed trusts (under which beneficiaries are entitled to fixed amounts or proportions of distributions) and ensures that the payment by a trustee of a supplementary dividend to a non-resident beneficiary will not contravene any terms of a fixed trust. It is not necessary to apply the provision to discretionary trusts as such trusts by their very nature have a free ability to pay different amounts to beneficiaries.

Section LB 1 (3) contains a rule to prevent streaming of imputation credits by trusts. This is achieved by providing that the amount of imputation credit allowed to each beneficiary of a trust is proportional to the distributions made to each beneficiary of the trust during the year.

Section LB 1 (3A) has been inserted to create an appropriate interface between the anti-imputation credit streaming rule for trusts in section LB 1 (3) and the FITC regime. The amendment will ensure that the effect of the current anti-imputation credit streaming rule for trusts is maintained.

Section LE 3 holding company mechanism

The holding company mechanism in section LE 3 allows the FITC regime to be used in circumstances where a New Zealand holding company will have an insufficient tax liability to utilise the FITC credit arising from paying a supplementary dividend to its non-resident shareholders. In short, the mechanism allows lower tier New Zealand companies to claim the FITC credit when paying dividends up the chain of companies to the ultimate New Zealand resident holding company with the non-resident shareholders.

Eligibility requirements (section LE 3 (1), (2) and (3))

A lower tier New Zealand company is entitled to a FITC credit when it pays a dividend and a supplementary dividend to a section LE 3 holding company. A section LE 3 holding company is a New Zealand resident company which:

- has given notice in writing to the lower tier dividend-paying company before the dividend is paid, advising the company that it is a section LE 3 holding company; and
- has not revoked that notice before the dividend is paid.

A notice of election to be a section LE 3 holding company will be treated as having being revoked by the section LE 3 holding company in *any* of the following circumstances:

- More than seven years have passed since the end of the year in which the notice was given. This seven-year maximum term for any election coincides with the record retention period and is necessary to ensure that companies can provide evidence of giving notice of an election to be a section LE 3 holding company if required to do so by Inland Revenue.
- The section LE 3 holding company elects to revoke the notice.
- The section LE 3 holding company does not have the purpose, in keeping the notice alive, of enabling (directly or indirectly) the payment of a supplementary dividend to a non-resident.
- The only persons holding voting interests in the section LE 3 holding company are residents of New Zealand. In other words, the section LE 3 holding company must have at least one ultimate non-resident shareholder. (Under the voting interest rules in section OD 3, voting interests in a company are traced through any interposed corporate shareholders to the ultimate individual shareholders.)
- The section LE 3 holding company is exempt from income tax on dividends (other than under section CB 10, which contains the exemption from income tax on foreign sourced dividends derived by New Zealand resident companies and the wholly-owned group inter-corporate dividend exemption).

If any of the preceding circumstances occur, the section LE 3 holding company is required to give notice in writing to the lower tier dividend-paying company of the deemed revocation as soon as practicable (section LE 3 (3)).

Application of section LE 3 mechanism (section LE 3 (4))

The primary section LE 2 tax credit mechanism applies in relation to the dividend and supplementary dividend paid by the lower tier dividend-paying company to the section LE 3 holding company as if the section LE 3 holding company were not resident in New Zealand. The dividend-paying company is accordingly entitled to a FITC credit because, in terms of LE 2 (1), the dividend and supplementary dividend it pays have been derived by a non-resident. Note that a section LE 3 holding company is not treated as a non-resident for the purposes of section LE 2 when it pays a dividend itself.

Associated persons - deferral of FITC credit (section LE 3 (5))

When a company pays a dividend and a supplementary dividend to an associated section LE 3 holding company with an earlier balance date, the related FITC credit will be first allowed to the dividend-paying company in its income year corresponding with the income year of the section LE 3 holding company at the time of the dividend payment.

This rule addresses the deferral opportunity that would otherwise occur if a section LE 3 holding company had an earlier balance date than the dividend-paying company. In such cases, the dividend could be assessable to the section LE 3 holding company in a later income year than the income year of the dividend paying company in which the FITC credit arises. The benefit of the deferral to associated companies has been denied by deferring the allowance of the FITC credit to the dividend-paying company.

Example 1

A dividend and a supplementary dividend are paid on 20 February 1996 by a company with a 30 June balance date to an associated section LE 3 holding company with a 31 December balance date. The FITC credit would be first allowed in the dividend-paying company’s 1996-97 income year (instead of its 1995-96 year). The dividend would be assessable in the section LE 3 holding company’s 1996-97 income year as usual.

The associated persons definition in section OD 8 (3) is used for the purpose of determining whether a dividend-paying company and a section LE 3 holding company are associated. However, a modification to that defini-

continued on page 30

from page 29
tion (for the purposes of section LE 3 (5) only) ensures that section LE 3 (5) will not apply to defer the allowance of any FITC credit in the case of a lower tier joint venture company of which two holding companies each own 50 percent.

Application of wholly-owned group inter-corporate dividend exemption and RWT rules (section LE 3 (6), (7), (8) and (9))

Section LE 3 (6) overrides the wholly-owned group exemption for dividends in section CB 10 (2), except to the extent to which the dividend is not fully imputed. The formula for determining the extent to which a dividend is fully imputed is:

$$(IC + SD) \quad x \quad \frac{1 - T}{T} \quad + \quad IC$$

In this formula:

IC is the imputation credit attached to the dividend.
SD is the supplementary dividend.
T is the company tax rate, expressed as a percentage.

The imputation credit is deemed, for the purposes of the imputation credit entitlement provision in section LB 2, to be included in the part of the dividend which is not exempt under section CB 10 (2).

Example 2

A cash dividend of $67 with a $10 imputation credit attached (post-FITC mechanism), together with a supplementary dividend of $5.58, is paid to a section LE 3 holding company. Applying the formula gives an amount of $41.63 as the fully imputed portion. The difference between this figure and the amount of the dividend ($77, being $67 cash plus $10 imputation) is $35.37, which is the amount of the cash dividend (representing the unimputed part of the dividend) which can continue to be exempt under section CB 10 (2).

A dividend paid to a section LE 3 holding company is exempt from resident withholding tax (RWT) to the extent that it is fully imputed. The formula in section LE 3 (6) is used to determine the extent to which the dividend is fully imputed and therefore not subject to RWT. The part of the dividend that is not imputed therefore remains subject to the same RWT treatment as it would have been outside of the FITC regime. The imputation credit is included in the part of the dividend that is exempt from RWT under this rule (section LE 3 (7)).

A supplementary dividend derived by a section LE 3 holding company is not exempt from tax under the wholly-owned group exemption for dividends in section CB 10 (2) (section LE 3 (8)). However, it will be exempt from the RWT rules (section LE 3 (9)).

Minimum income tax payable by a section LE 3 holding company (section LE 3 (10) and (11))

Section LE 3 (10) provides that, notwithstanding any other provision in the Income Tax Act 1994, a section LE 3 holding company has a minimum amount of income tax payable for an income year equal to the supplementary dividends derived by it during that income year. The provision ensures that if a section LE 3 holding company otherwise does not have sufficient income tax payable (e.g., it is in a loss position), it would at least be required to pay as income tax the amount of any supplementary dividends it derives. This requirement is designed to both protect the revenue, and to ensure that the holding company has a refundable tax liability against which a FITC credit may be offset.

Section LE 3 (11) converts any additional tax paid under section LE 3 (10) into a loss to carry forward. The provision will generally apply to companies in loss and allows the reinstatement of tax losses. The crediting of tax under section LE 2 constitutes payment for the purposes of section LE 3 (11).

The conversion of any additional tax paid under subsection (10) into a loss carried forward is achieved by dividing the amount of additional tax by the company tax rate (expressed as a percentage).

Example 3

A section LE 3 holding company with a $100 carried forward loss derives $100 of taxable profits in the income year, comprised of a $67 cash dividend, with a $21.18 imputation credit attached, and a supplementary dividend of $11.82. The company is required under section LE 3 (10) to pay $11.82 of income tax. This minimum amount payable of $11.82 is converted into a $35.82 loss under section LE 3 (11). The $21.18 imputation credit gives rise to a $64.18 loss under section LB 2 (3). Therefore the section LE 3 holding company is reinstated with $100 of losses to carry forward to the next income year.

This deemed loss is additional to any other loss for the income year that the section LE 3 holding company may have.

Example 4: section LE 3 holding company

A New Zealand resident operating company has a pre-tax profit of $200 for an income year. The operating company is 50 percent owned by a 100 percent foreign-owned New Zealand resident holding company, and 50 percent owned by a New Zealand resident. The holding company gives notice in writing to the operating company under section LE 3 (2) that it is a section LE 3 holding company.

Page 31 sets out the resulting tax calculations under the FITC mechanism.

	Total	New Zealand Resident	Holding Company
Operating Company			
Cash Position			
Profit before tax	200.00		
Tax payable	(66.00)		
Tax credit	11.82		
	145.82		
Dividend	134.00	67.00	67.00
Supplementary dividend	11.82		11.82
	145.82		78.82
Cash paid to shareholders	145.82	67.00	78.82
Imputation Position (assuming tax paid and FITC subsequently refunded)			
Tax paid	66.00		
Imputation credits attached to dividends paid	(54.18)	33.00	21.18
Tax refund	(11.82)		
	0.00		
Holding Company			
Tax Position			
Dividends derived (including supplementary dividend)		78.82	
Imputation credits received		21.18	
Taxable dividend		100.00	
Tax		33.00	
Less imputation credits		(21.18)	
Less FITC credit (once dividend passed on)		(11.82)	
Net tax liability		0.00	
Cash Position			
Dividend derived (including supplementary dividend)		78.82	
Dividend for foreign parent	67.00		
Supplementary dividend	11.82		
	78.82		
NRWT @ 15%	(11.82)		
Net dividend to shareholder	67.00		
NRWT to IRD		(11.82)	
Net cash paid		67.00	
Imputation Position			
Credit attached to dividend received		21.18	
Tax paid:			
- Tax payable	11.82		
- FITC credit refund	(11.82)		
Credits attached to dividend paid		(21.18)	
		0.00	

International tax - other related amendments

Reduction in branch profits tax rate (Clause 5 of Part A of Schedule 1, Income Tax Act 1994)

The tax rate on the New Zealand branch income of non-resident companies has been reduced from 38% to 33%, with effect from the 1996-97 income year.

The reduction in the branch profits tax rate is consistent with the extension of the foreign investor tax credit (FITC) regime to non-resident direct investors. The FITC regime reduces the maximum rate of tax on non-resident investors (taking into account the combined effect of company tax and NRWT) to 33%. As a branch structure is a substitute for a majority equity investment in a New Zealand company by a non-resident, it should not be subject to a higher rate of taxation.

The removal of the higher 38% rate of tax on the New Zealand branch income of non-resident companies has been achieved by simply repealing clauses 3 and 6 of Part A of Schedule 1 of the Income Tax Act 1994. Clause 6 set the higher 38% rate of tax for non-resident companies. Clause 3 also imposed a higher 38% on non-resident mining operators. A new clause 5 has been substituted which simply sets a 33% rate for all companies. The former clause 5 referred to New Zealand resident companies. Consequential amendments have also been made to sections CN 4 (1) and DN 5 (2).

NRWT rate reduction on fully imputed dividends (section NG 2)

The NRWT rate has been reduced from 30% to 15% on dividends paid to non-resident investors on or after 12 December 1995 to the extent the dividends are fully imputed.

Previously, investors resident in countries with which New Zealand did not have a double tax agreement were subject to a 30% NRWT rate, while investors resident in treaty countries were generally subject to a 15% NRWT rate by virtue of the maximum rate relief provision for dividends in the relevant double tax agreement. The reduction in the domestic rate of NRWT on dividends paid to non-residents from 30% to 15% ensures equal treatment of investors resident in treaty and non-treaty countries when such dividends are fully imputed.

The NRWT rate reduction on fully imputed dividends is consistent with the extension of the FITC regime to non-resident direct investors. The effect of the FITC regime, in conjunction with the NRWT rate reduction, is to reduce the maximum rate of tax on non-resident investors (combining company tax and NRWT) to the New Zealand company rate of 33%, regardless of the country of residence of the non-resident.

The reduction in the NRWT rate on fully imputed dividends from 30% to 15% is also consistent with the new branch profits tax rate of 33%, which applies whether or not the head office is in a treaty country. Without such a NRWT reduction, there would have been a tax preference for non-treaty country investors to adopt a branch structure for investment into New Zealand.

A 30% rate of NRWT on dividends will continue to apply to dividends to the extent that they are not fully imputed. However, the portion of any dividends which are not fully imputed and which is paid to an investor resident in a country with which New Zealand has a double tax agreement will continue to be generally subject to a 15% NRWT rate by virtue of the application of the maximum rate relief provision for dividends in the relevant double tax agreement.

Section NG 2 (3) contains the following formula for calculating the portion of any dividends which is fully imputed:

$$(IC + SD) \quad x \quad \frac{1 - T}{T}$$

In this formula:

IC is the amount of imputation credits attached to the dividends.

SD is the amount of supplementary dividends payable as a result of Part LE in respect of the dividend.

T is the rate of resident companies' tax, expressed as a percentage, stated in clause 5 of Part A of Schedule 1 and applying in respect of the income year that is concurrent with the imputation year in which the dividends are paid.

A supplementary dividend is subject always to a 15% NRWT rate only.

Example 1

A $67 cash dividend with a $21.18 imputation credit attached, together with an $11.82 supplementary dividend, is paid to an investor resident in a country with which New Zealand does not have a double tax agreement. Applying the formula above gives a $67 result. Therefore the entire cash dividend of $67 is subject to an NRWT rate of 15%. (The $11.82 supplementary dividend is also subject to a 15% NRWT rate.)

Example 2

A $67 cash dividend with a $16 imputation credit attached, together with an $8.93 supplementary dividend, is paid to an investor resident in a country with which New Zealand does not have a double tax agreement. Applying the formula above gives a $50.61 result. Therefore a $50.61 portion of the $67 cash dividend is subject to a 15% NRWT rate while the remaining $16.29 portion is subject to a 30% NRWT rate (the $8.93 supplementary dividend is subject to a 15% NRWT rate).

NRWT rate on fully imputed non-cash dividends (sections NG 2 (1) (b)(ii) and OB 1)

The NRWT rate on fully imputed non-cash dividends (as defined in section OB 1) paid to non-resident investors on or after 12 December 1995 is zero percent.

Non-cash dividends are also excluded from the FITC regime. This is achieved by excluding non-cash dividends from the new dividend definition applying for FITC purposes (Part LE), contained in paragraph (ba)(ii)(A) of the definition of the term "dividend" in section OB 1. This exclusion is appropriate as the FITC mechanism is structured on the assumption that NRWT is imposed on the dividend, whereas a zero rate of NRWT now applies to non-cash dividends to the extent fully imputed.

Again, the NRWT zero rating of non-cash dividends to the extent fully imputed is consistent with the extension of the FITC regime to non-resident direct investors. The effect of both the FITC regime and the NRWT zero rating of non-cash dividends to the extent fully imputed is to reduce the maximum rate of New Zealand tax on non-resident equity investors (combining company tax and NRWT) to the New Zealand company rate of 33%. Requiring non-cash dividends to be fully imputed before they qualify for the NRWT zero rate ensures that the zero rating only applies to the extent that full company tax has been paid on the underlying company income.

The NRWT zero rating of non-cash dividends to the extent fully imputed (rather than excluding such dividends from the definition of non-resident withholding income) ensures that such dividends are not subject to a separate income tax liability as they qualify for "NRWT as a final tax" treatment under section NG 3.

The NRWT zero rating of non-cash dividends to the extent fully imputed was intended, in part, to address the mainly transitional issue of retained earnings and imputation credits being distributed in corporate groups in such a manner so as to make the utilisation of the FITC regime difficult. This would be the case, for example, where the holding company derives only non-assessable dividend income and therefore has no tax liability against which to offset its FITC credit resulting from supplementary dividends it pays to its non-resident shareholders, while the lower tier operating subsidiary has an insufficient credit balance in its imputation credit account (because it has paid fully imputed dividends to the holding company) to allow a refund of the FITC credit. (Because the imputation rules limit a tax refund to the amount of the credit balance in a company's imputation credit account, the absence of such a credit balance would prevent the FITC credit being refunded to the subsidiary.)

The NRWT zero rating of non-cash dividends to the extent fully imputed therefore allows taxpayers to distribute earnings in New Zealand holding companies to non-resident shareholders by way of fully imputed taxable bonus issues which can be subsequently redeemed.

If such taxable bonus issues are of non-participating redeemable shares, their subsequent redemption should not be liable to tax as a dividend under section CF 2 (1)(g). This is because non-participating redeemable shares are exempt from the brightline tests in section CF 3 (1)(b)(i). Additionally, in terms of the anti-avoidance rule in section CF 3 (1)(b)(iii), Inland Revenue is likely to be satisfied that a particular redemption of fully imputed taxable bonus issue shares is not in lieu of a dividend.

The extent to which non-cash dividends are fully imputed is calculated according to the formula in new section NG 2 (3) (see page 32).

The Commissioner has made a determination under section NG 10 that all persons are relieved from the obligation to comply with section NG 9 (1) in respect of non-cash dividends which are fully imputed and accordingly subject to a zero percent NRWT rate under section NG 2 (1)(b)(ii). Section NG 10 allows the Commissioner to relieve any person (the company paying the non-cash dividend) from an obligation to deduct NRWT in accordance with section NG 9. (Section NG 9 deals with the calculation of the amount of NRWT required to be deducted by a company paying a non-cash dividend to a non-resident.)

Life insurer related amendments (sections NG 2 (1)(b)(iii), NG 3 (ba) and OB 1)

Most non-resident life insurers with New Zealand branch operations have elected under section OE 3 for their New Zealand branches to be treated as separate New Zealand resident companies for New Zealand income tax purposes.

Section NG 2 (1)(b)(iii) imposes a zero percent NRWT rate on all non-resident withholding income (dividends, interest or royalties) derived by a non-resident life insurer on or after 12 December 1995 from its New Zealand branch that is deemed to be a separate New Zealand resident company by virtue of an election having been made under section OE 3.

To ensure that the zero rate of NRWT is a final New Zealand tax on non-resident withholding income derived by a non-resident life insurer from its deemed New Zealand resident subsidiary, a reference to interest or royalties so derived by a non-resident life insurer has been included in section NG 3 (ba). Section NG 3 stipulates those cases in which NRWT is a final New Zealand tax, that is, there is no separate imposition of income tax. (NRWT is always imposed on dividends as a final New Zealand tax.)

The zero percent NRWT rate on distributions made by a deemed New Zealand resident life company to its non-resident life insurer parent is consistent with the reduction in the non-resident company tax rate from 38% to 33% and the extension of the FITC regime to non-resident direct investors.

continued on page 34

from page 33

A dividend derived by a non-resident life insurer from its deemed New Zealand resident subsidiary is excluded from the FITC regime (paragraph (ba)(ii)(B) of the definition of the term “dividend” in section OB 1, which applies for FITC purposes). This exclusion is necessary because the FITC regime is structured on the assumption that a 15% NRWT rate applies to dividends paid to non-residents.

Repeal of project-specific tax concessions for non-residents (sections KF 1 and KF 2)

The non-resident investment company and special development project rebate provisions (contained principally in sections KF 1 and KF 2) have been repealed with effect from the 1996-97 income year. These project-specific tax concessions have been repealed because they are inconsistent with the Government’s “broad-base/low-rate” tax strategy. Other reforms, such as the approved issuer levy, the foreign investor tax credit regime, and the reduction in the non-resident company tax rate from 38% to 33%, also make these project-specific tax concessions largely redundant. The provisions have only been infrequently applied since their inception.

The following associated provisions have also been consequentially repealed or amended: sections CZ 5, NF 1 (2)(a)(vi), NG 1 (2)(f), NG 3, OB 5, OB 6 (1), OF 2 (2)(m)(iv), and associated definitions of terms in section OB 1.

The three special development project Orders in Council relating to section KF 2 which were previously in force have also been revoked with effect from the 1996-97 income year.

A savings provision (section KZ 3) allows some of the non-resident investment company rebates (those specified in section KF 1 (2) and (3)) to continue to apply in respect of the development projects specified in the four non-resident investment company Orders in Council currently in force.

Due dates reminder

April 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 31 March 1996 due.

7 Provisional tax and/or Student Loan interim repayments: first 1997 instalment due for taxpayers with December balance dates.
Second 1996 instalment due for taxpayers with August balance dates.
Third 1996 instalment due for taxpayers with April balance dates.

(We will accept payments received on Monday 8 April as in time for 7 April.)

20 Large employers: PAYE deductions and deduction schedules for period ended 15 April 1996 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 March 1996 due.

Employers: yellow copies of IR 12 and IR 13 certificates for year ended 31 March 1996 to be given to employees.

FBT return and payment due for quarter ended 31 March 1996.

Gaming machine duty return and payment for month ended 31 March 1996 due.

RWT on interest deducted during March 1996 due for monthly payers.

RWT on interest deducted 1 October 1995 to 31 March 1996 due for six-monthly payers.

RWT on dividends deducted during March 1996 due.

Non-resident withholding tax (or approved issuer levy) deducted during March 1996 due.

30 GST return and payment for period ended 31 March 1996 due.

May 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 30 April 1996 due.

(We will accept payments received on Monday 6 May as in time for 5 May.)

7 Provisional tax and/or Student Loan interim repayments: first 1997 instalment due for taxpayers with January balance dates.
Second 1996 instalment due for taxpayers with September balance dates.
Third 1996 instalment due for taxpayers with May balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 May 1996 due.

Small employers: PAYE deductions and deduction schedules for period ended 30 April 1996 due.

Gaming machine duty return and payment for month ended 30 April 1996 due.

RWT on interest deducted during April 1996 due for monthly payers.

RWT on dividends deducted during April 1996 due.

Non-resident withholding tax (or approved issuer levy) deducted during April 1996 due.

31 GST return and payment for period ended 30 April 1996 due.

FBT annual liable return (1 April 1995-31 March 1996) and payment due for employers who elected to pay FBT on an annual basis.

PAYE/ACC: 1996 PAYE and earner premium reconciliation (IR 68P) and 1996 ACC employer premium calculation (IR 68A) due, and 1996 ACC employer premium to be paid.

RWT on interest: annual reconciliation statement (IR 15S) due.

RWT on dividends: specified dividend reconciliation (IR 17S or IR 17SA) due.

Contents

Volume Seven, No.11 March 1996

The Taxation (International Tax) Bill was introduced in August 1995. It resulted in the enactment of these Amendment Acts on 12 December 1995:

- Income Tax Act 1994 Amendment Act (No.3) 1995 [No.71]
- Tax Administration Amendment Act (No.2) 1995 [No.72]

This Tax Information Bulletin deals with the legislation contained in these Acts. The main features of the new legislation are:

- a new transfer pricing regime
- a thin capitalisation regime
- an extension of the foreign investor tax credit regime to foreign direct investors
- a reduction in the tax rate on the New Zealand branch income of non-resident companies from 38% to 33%
- a reduction in the non-resident withholding tax rate on fully imputed dividends from 30% to 15%.

These reforms follow on from the Government's *International Tax - A Discussion Document*, which was released in February 1995. They are a further part of the reform of New Zealand's international tax regime that began in 1988.

See the inside front cover for a list of this TIB's contents.

This TIB has no appendix