TAXATION (INTERNATIONAL TAX) BILL

EXPLANATORY NOTE

THIS Bill amends the Income Tax Act 1994 and the Tax Administration Act 1994 to introduce the transfer pricing regime, the thin capitalisation regime, and the amended foreign investor tax credit regime that were foreshadowed in the discussion document on international tax released by the Government earlier this year.

Associated with these changes is an effective reduction in the maximum rate of tax on income derived by non-resident investors to the standard New Zealand company rate of 33%.

The Bill also makes certain other consequential or minor changes to provisions dealing with international tax.

The transfer pricing and thin capitalisation regimes take effect from the 1996–97 income year.

The amendments to the foreign investor tax credit regime apply to dividends paid on or after the day on which the Bill receives the Royal assent.

PART I
INCOME TAX

THIS Part amends the Income Tax Act 1994.

Clause 3 amends section CF 2 of the Act, which defines the term "dividends" for the purposes of the Act, to ensure that there is a correct cross-reference to the amended foreign investor tax credit regime in the new *Part LE*.

Clause 4 amends section CG 11 of the Act, which sets out rules for calculation of branch equivalent income for the purposes of the controlled foreign company regime, consequential upon the introduction of the new transfer pricing rules and the thin capitalisation regime.

Clause 5 amends section CN 4 of the Act, which relates to non-resident insurers, to substitute a reference to the standard rate of company tax for the existing reference to the non-resident company rate of tax.

Clause 6 repeals section CZ 5 of the Act as spent. The section relates to the partial exemption of certain life insurance companies in respect of interest on debentures issued before 26 August 1966 in respect of development projects specified by Order in Council under section OB 5 of the Act.

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Clause 7 amends section DN 5 (2) of the Act, which relates to the taxation of non-resident mining operators, to remove a reference to Schedule 1 as a consequence of the removal of the separate non-resident company rate of tax.

Clause 8 repeals subsection (1) of section FB 2 of the Act, which gives the Commissioner power to make an appropriate apportionment in circumstances where income is partly derived in New Zealand and partly derived elsewhere, and substitutes new subsections clarifying the scope of the Commissioner's apportionment powers and reflecting the approach commonly adopted in New Zealand's double taxation agreements.

Clause 9 introduces a new *Subpart FG* into the Act to provide for the thin capitalisation regime foreshadowed by the Government in the discussion document on international tax released earlier this year. Generally, the regime aims to ensure an appropriate apportionment to New Zealand of worldwide interest costs in circumstances where a New Zealand taxpayer controlled by a single non-resident has a level of debt which exceeds both—

(a) A safe harbour debt to total assets ratio of 75 percent; and

(b) 110 percent of the taxpayer's worldwide group's ratio of debt to total assets.

The new *section FG 1* is a purpose provision describing generally the purpose of the new Subpart.

The new *section FG 2* specifies, in *subsection (1)*, the entities to which the new thin capitalisation regime can apply, being any taxpayer which is non-resident, a company controlled by a single non-resident, or a trustee of a non-qualifying trust 50 percent or more settled by a single non-resident.

Subsection (2) details the rules for determining when a company is controlled by a single non-resident.

Subsection (3) modifies the normal look-through control rules to ensure that any circumstance of control at any level of ownership by a single non-resident triggers operation of the new thin capitalisation regime.

Subsection (4) details the circumstances in which a trust will be treated as being 50 percent or more settled by a single non-resident.

Subsection (5) ensures that the regime applies in circumstances where a New Zealand resident company is treated as being non-resident under tax treaty provisions.

The new *section FG 3* stipulates the ratios of debt to total assets which must be exceeded in order for the thin capitalisation interest apportionment rule to apply. Specifically, the debt to total assets ratio of the taxpayer's New Zealand group must exceed both 75 percent and the percentage that is calculated by multiplying the worldwide group debt percentage of the taxpayer by 1.1.

The new *section FG 4* stipulates the rules for calculating the taxpayer's New Zealand group debt percentage.

Subsection (1) sets out the general rule that it is to be the percentage which the total debt of the New Zealand group represents of total assets.

Subsection (2) defines debt to include only those financial arrangements which both provide funds to the issuer and give rise to a tax deduction other than a tax deduction merely resulting from currency rate movements. The intent of the latter restriction is to exclude interest-free debt.

Subsection (3) gives taxpayers the option of measuring debt at the average of the daily figures, the average of the quarterly figures, or the highest total recorded at any time during the year.

Subsection (4) stipulates that total assets is to mean total assets at the end of the income year, and provides that the taxpayer has an election whether to measure total assets at the value shown in the financial accounts, at market values, or at a combination of those values (if permitted by generally accepted accounting principles).

Subsection (5) is a technical provision necessary to deal with situations where the taxpayer (or another group company) is liquidated before the end of the income year.

Subsection (6) provides that asset valuations must be in accordance with generally accepted accounting principles of New Zealand.

Subsection (7) provides that calculations must be in New Zealand currency and close of trading spot exchange rates are to be used for currency conversion.

Subsection (8) is an anti-avoidance rule providing that temporary reductions in debt or increases in assets are to be disregarded if defeating the intent and application of the thin capitalisation regime.

Subsection (9) details what constitutes the taxpayer's New Zealand group in the case of a taxpayer which is a company, and requires calculations to be on a group consolidated basis under New Zealand's generally accepted accounting principles. Generally, the group comprises all companies which are resident in New Zealand or carrying on business in New Zealand through a fixed establishment in New Zealand, which are the taxpayer or (at the taxpayer's election) companies required to be consolidated with the taxpayer under generally accepted accounting principles of New Zealand or members of the same tax group as the taxpayer.

Subsection (10) provides for an equivalent rule for defining the taxpayer's New Zealand group in the case of a taxpayer who is an individual or a trustee. In this case, the group is to comprise the taxpayer and all associated persons which are resident in New Zealand or carrying on business in New Zealand through a fixed establishment in New Zealand.

Subsection (11) provides that, if any member of the group is not resident in New Zealand but merely carrying on business in New Zealand through a fixed establishment in New Zealand, the consolidated calculations will include only that part of the member's total assets and total debt that is attributable to the business carried on in New Zealand.

Subsection (12) provides that an individual taxpayer must not include private or domestic assets in calculating total assets.

The new *section FG 5* sets out rules for calculating the taxpayer's worldwide group debt percentage.

Subsection (1) provides generally that the percentage is to be the percentage of total debt to total assets for the taxpayer's worldwide group for the accounting year of the group ending prior to the relevant income year.

Subsection (2) provides that, generally, either or both total debt and total assets can be taken from the financial accounts of the group.

Subsection (3) provides that the amounts are to be measured as at the end of the accounting year immediately preceding the income year.

Subsection (4) is a technical provision necessary to deal with situations where the taxpayer (or another group company) is liquidated before the end of the income year.

Subsection (5) provides that the amount of total assets and total debt must be calculated under the generally accepted accounting principles of New Zealand or

an equivalent standard in a country in which the company in the group with the highest amount of total assets is resident.

Subsection (6) permits, however, total debt to be measured, at the election of the taxpayer, using either or both the definition of debt contained in the new *section FG 4 (2)* and the averaging rules in *section FG 4 (3)*.

Subsection (7) requires calculations to be in New Zealand currency and for currency conversions to be at close of trading spot exchange rates.

Subsection (8) is an anti-avoidance rule providing that temporary reductions in debt or increases in assets are to be disregarded if defeating the intent and application of the thin capitalisation rules.

Subsection (9) defines the taxpayer's worldwide group in the case of a company as being the taxpayer and all companies required to be consolidated with the taxpayer under generally accepted accounting principles, and requires consolidation on the basis of New Zealand's generally accepted accounting principles or the equivalent accounting standard of the country in which the company in the group with the highest amount of total assets is resident.

Subsection (10) defines the worldwide group in the case of an individual or a trustee as being the taxpayer and all associated persons.

Subsection (11) provides that if the taxpayer is an individual, private and domestic assets and debt incurred to acquire private and domestic assets are excluded from the calculations.

Subsection (12) provides that if it is impractical for the taxpayer to calculate the worldwide group debt percentage, the taxpayer may elect that the Commissioner must estimate the percentage. If the Commissioner makes an estimate, that percentage is to be treated as the worldwide group debt percentage. If the Commissioner is not asked to or cannot make an estimate, the worldwide group debt percentage is to be treated as being 68.1818 (which figure, when multiplied by the 110% multiplying factor in *section FG 3*, equates to 75%).

The new *section FG 6* provides concessionary rules for application in circumstances where debt funding is on-lent.

Subsection (1) provides that, when calculating the New Zealand group debt percentage, both total debt and total assets are to be reduced by the outstanding balance of any financial arrangement of which the taxpayer (or another group member) is the holder and of which the issuer is either a non-associated person or a person neither resident nor carrying on business in New Zealand.

Subsection (2) prevents *subsection (1)* from applying to a financial arrangement already excluded from calculations by *section FG 4 (2)*.

Subsection (3) provides that, when calculating the worldwide group debt percentage, both total debt and total assets are to be reduced by the amount of any financial arrangement held by the taxpayer (or another relevant group member) and issued by a non-associated person.

The new *section FG 7* provides a concession for exchange rate fluctuations. The taxpayer may elect, in the case of any one or more debt amounts or assets denominated in foreign currency, to undertake a currency conversion using the forward exchange rate for the relevant measurement date applicable on the first day of the income year.

The new *section FG 8* provides for the actual apportionment of interest costs resultant from breaching the thin capitalisation thresholds. If a taxpayer's New Zealand group debt percentage fails the test in *section FG 3*, the amount deductible by the taxpayer under section DD 1 (b) (which relates generally to the claiming of interest deductions) is to be reduced by the same ratio by which the taxpayer's

New Zealand group debt percentage exceeds the greater of (i) 75%, or (ii) 110% of the taxpayer's worldwide group debt percentage. Under *subsection (2)*, another member of the same wholly-owned group can elect to suffer the reduction instead of the taxpayer.

The new *section FG 9* stipulates that any elections able to be made by the taxpayer under the thin capitalisation regime can be made simply by filing an appropriate return of income. *Subsection (2)* permits an amendment to elections in certain cases.

Clause 10 repeals section GC 1, which currently gives the Commissioner a general power to make arbitrary assessments in circumstances where a business controlled by non-residents appears to produce insufficient income or excess losses, and substitutes a more specific anti-avoidance provision. The more specific provision bolsters application of the new general transfer pricing regime in *section GD 13* by allowing the application of the *section GD 13* rules in circumstances where an arrangement is not specifically within the ambit of *section GD 13* but has been entered into with an avoidance purpose or effect.

Clause 11 repeals section GC 13, which is a specific anti-avoidance provision applying in respect of the current foreign portfolio investor tax credit regime. The provision is no longer necessary as the foreign investor tax credit regime in the new *Part LE* is not limited to portfolio investors.

Clause 12 introduces the new general transfer pricing regime foreshadowed in the Government's discussion document on international tax released earlier this year. Generally, the new *section GD 13* requires taxpayers who enter into cross-border arrangements with associated persons at a consideration which reduces the taxpayer's net income or increases the taxpayer's net loss to substitute an arm's length consideration when calculating the taxpayer's net income.

Subsection (1) is a purpose provision describing generally the purpose of the new section.

Subsection (2) specifies broadly the types of arrangements to which the transfer pricing regime applies and indicates the extent to which the arrangements must be cross-border.

Subsections (3) and (4) specifically require the substitution of arm's length amounts if the taxpayer is paying an excessive amount or receiving an insufficient amount.

Subsection (5) provides an exemption in circumstances where the amount which would be deemed to be increased is subject only to a form of non-resident withholding tax and the payer of the amount can claim an income tax deduction, meaning that there is no potential for reduction of the New Zealand tax base.

Subsections (6) to (9) set out the criteria for determining the method of calculation of an arm's length price and allow the Commissioner to substitute a more reliable price in certain limited circumstances.

Subsection (10) allows for compensating favourable adjustments in the case of a taxpayer who is subject to an adverse transfer pricing adjustment in the same income year in a transaction involving the same other party.

Subsection (11) allows for substitution of an arm's length amount for the purposes of calculating taxation of the other party if the Commissioner considers it is fair and reasonable.

Subsection (12) clarifies that, except to the extent to which *subsection (11)* applies, the transfer pricing adjustment affects only the taxpayer and does not

impact upon the taxpayer's obligation to deduct withholding tax, particularly in a case where the other party is deriving a dividend.

Subsection (13) inserts certain definitions for the purposes of the new section.

Clause 13 repeals sections KF 1 and KF 2 of the Act, which provide rebates for non-residents in relation to certain development projects specified by Order in Council.

The rebates in section KF 2 and in section KF 1 (1) are superseded by the removal of the separate non-resident company tax rate of 38% and its replacement by the standard company rate of 33%.

The rebates in section KF 1 (2) and (3), which ensure that New Zealand tax in respect of the development projects will not exceed the tax that would have been paid in the non-resident investment company's home country, are not so clearly made redundant by the reduction in the tax rate. For this reason the eligibility for these rebates of the 4 development projects currently specified by Order in Council is expressly saved by the new *section KZ 3* inserted by *clause 14* of the Bill.

Clause 14 inserts a new *section KZ 3* into the Act that is in effect a savings provision for the 4 remaining live projects specified in Non-Resident Investment Company Orders in Council made for the purposes of the now-repealed section KF 1. That section currently contains 3 types of rebate for development projects specified by Order in Council.

The first rebate, in section KF 1 (1), is 5% of any interest income earned by the relevant company, reducing the rate of New Zealand tax on interest from the 38% currently applying to non-residents to 33%. This rebate is not continued for the development projects, as having been superseded by the general reduction in the non-resident rate effected by the amendments to Schedule 1 of the Act.

The rebates in section KF 1 (2) and (3) are however continued for the specified projects. These rebates ensure that the New Zealand tax on interest and dividends earned by a non-resident investment company does not exceed that which the company would have paid had it earned the interest or dividends in its home country.

Clause 15 amends section LD 3, which provides for resident withholding tax deductions to be credited against income tax assessed, to ensure that there is a correct cross-reference to the amended foreign investor tax credit regime in the new *Part LE*.

Clause 16 repeals the existing Part LE, which provides for a tax credit enabling companies to pay supplementary dividends to foreign portfolio investors ensuring that the total New Zealand tax imposed on income distributed is no more than 33%, and substitutes a new *Part LE* which provides for the tax credit to be available whether or not the foreign investor is a portfolio (less than 10%) investor. The new Part also provides for a mechanism to allow use of the foreign investor tax credit regime in circumstances where a New Zealand holding company will have insufficient tax liability to utilise the foreign investor tax credit arising from paying a supplementary dividend.

The new *section LE 1* is a purpose provision explaining the purpose of the new *Part LE*.

The new *section LE 2* sets out the mechanism for calculation of the tax credit. In general terms, the mechanism is the same as that currently applicable under the existing section LE 1. The amount of tax credit is calculated by reference to the imputation credit attached to a dividend paid to a foreign investor. In essence, where a dividend would have been fully imputed but for the availability of the

foreign investor tax credit, the tax credit will give the company a benefit sufficient to fund a supplementary dividend which will ensure that the amount distributed bears no more than 33% New Zealand tax.

Subsection (1) stipulates the circumstances in which the section can apply—being generally where a dividend and a supplementary dividend are paid to the same non-resident shareholder.

Subsection (2) gives the formula for calculation of the tax credit, being the imputation credit attached to the dividend multiplied by 0.5583.

Subsection (3) stipulates the order in which the foreign investor tax credit can be claimed against income tax.

Subsections (4) to (7) provide for the tax credit to be claimed first against the income tax payable by the company for the relevant year but, if the company does not have sufficient tax payable, also enable the tax credit to be claimed against income tax payable by another member of the same wholly-owned group in that income year or by the company or such other group member in any one of the 4 preceding income years (not being a year prior to the 1993–94 income year).

Subsections (8) and (9) are mechanical provisions to ensure that the necessary reduction of the actual imputation credit attached to the dividend resulting from the claiming of the foreign investor tax credit and the absence of any imputation credit attached to the supplementary dividend do not cause any breaches of the various rules concerning the attachment of imputation credits contained in Part ME.

Subsection (10) provides that the payment of a supplementary dividend will not breach other rules of law (particularly company law) which require shareholders to receive the same amount of dividends.

Subsection (11) contains an equivalent rule for trustees on-distributing supplementary dividends.

The new *section LE 3* provides a mechanism allowing holding companies which do not generate a sufficient tax liability to use the foreign investor tax credit regime. In general terms, the mechanism allows lower tier New Zealand companies to claim the foreign investor tax credit when paying dividends up the chain of companies to the holding company.

Subsection (1) provides for the holding company mechanism to apply in cases where there is a "section LE 3 holding company".

Subsections (2) and (3) stipulate that a "section LE 3 holding company" is a company resident in New Zealand which has given notice before the start of the relevant year confirming, inter alia, that it has at least one ultimate investor not resident in New Zealand, it is not exempt from tax (other than under section CB 10 (2)), it is giving the notice for the purpose of enabling the payment of a supplementary dividend to a person not resident in New Zealand and it has a reasonable expectation that it will not otherwise have sufficient income tax payable for a year against which to claim any foreign investor tax credit when itself paying a supplementary dividend.

Subsection (4) simply applies the *section LE 2* tax credit mechanism to section LE 3 holding companies.

Subsections (5) and (6) override the exemption for dividends in section CB 10 (2) and the RWT rules, in the case of any dividend received by a section LE 3 holding company to which *section LE 3* applies, except to the extent to which the dividend is not fully imputed.

Subsections (7) and (8) provide that any supplementary dividend received by a section LE 3 holding company is similarly not exempt from tax under section CB 10 (2) and similarly is exempt from the RWT rules.

Subsection (9) provides that the section LE 3 holding company has a minimum income tax liability for the income year equal to the supplementary dividends derived by it. Effectively, this means that the section LE 3 holding company will be subject to income tax if it does not utilise the supplementary dividends to on-pay equal amounts of supplementary dividends.

Subsection (10) provides for the retention of tax losses in circumstances where *subsection (9)* has applied to require tax to be paid in circumstances where there is no assessable income, and the creation of notional tax losses in circumstances where *subsection (9)* has applied to require extra tax to be paid in circumstances where there is an insufficient tax liability.

Clause 17 amends section ME 4, which relates to credits arising to the imputation credit account, to ensure a correct cross-reference to the amended foreign investor tax credit regime in the new *Part LE*.

Clause 18 repeals the existing section ME 6, which gives a company the ability to attach imputation credits to dividends, and substitutes a new section giving a company a general ability to attach imputation credits to dividends at the time of payment but also an ability to retrospectively attach imputation credits, in certain circumstances, where a non-cash dividend is subject to a transfer pricing adjustment under the new *section GD 13*.

Clause 19 removes from section NF 1, which deals with the application of resident withholding tax, a reference to interest income derived by non-resident investment companies from development investments. This is consequential on the repeal of section KF 1 of the Act.

Clause 20 amends section NG 1 (2), which stipulates the income which is subject to non-resident withholding tax or alternatively exempt from non-resident withholding tax, to provide that any deemed dividends and other income derived by a life insurance company from its New Zealand operations, which the life insurance company has elected to treat as a subsidiary company under section OE 3, are exempt from non-resident withholding tax.

The clause also removes from section NG 1 a reference to interest income derived by non-resident investment companies from development investments as a consequence of the repeal of section KF 1 of the Act.

Clause 21 repeals section NG 2, which imposes non-resident withholding tax and stipulates the rate of non-resident withholding tax, and substitutes a replacement section which also provides that the maximum 30% rate of non-resident withholding tax on dividends only applies to the extent to which the dividends are not fully imputed, and that a zero rate of non-resident withholding tax applies to non-cash dividends to the extent fully imputed. A new *subsection (3)* is inserted to provide for a formula for calculating that portion of any dividends which is fully imputed.

Clause 22 removes from section NG 3 a reference to the now-repealed section KF 1.

Clause 23 amends section OB 1 to—

(a) Make various amendments to the definitions contained in section OB 1 consequent upon the introduction of the amended foreign investor tax credit regime in the new *Part LE*; and

(b) Insert 2 definitions of terms used in the thin capitalisation regime in the new *Part FG*; and

(c) Insert cross-references to 3 terms defined in the new *section GD 13*; and

(d) Amend the definition of "fixed rate share" so that it applies also for the purposes of the new transfer pricing regime in *section GD 13*; and

(e) Amend the definition of "settlement" so that it applies also for the purposes of *section FG 2* of the new thin capitalisation regime; and

(f) Repeal or remove references to terms defined for the purposes of the now repealed sections CZ 5, KF 1, and KF 2.

Subclause (5) amends the definition of "associated person" to remove a cross-reference to the former section LE 1 as there is no longer a general prohibition on the use of the foreign investor tax credit regime in the case of associated foreign investors.

Subclause (7)(b) and (c) amend the definition of the term "dividend" to provide for a specific definition applicable for the purposes of the amended foreign investor tax credit regime in the new *Part LE*. Specifically, the foreign investor tax credit regime is not available in the case of non-cash dividends, or of deemed dividends derived by a life insurer from its New Zealand operations which the life insurer has elected to treat as a subsidiary company under section OE 3.

Clause 24 repeals section OB 5, which defines the term "non-resident investment company", as a consequence of the removal of rebates for such companies effected by *clause 13's* repeal of sections KF 1 and KF 2.

Clause 25 amends section OB 6 (1) of the Act to remove references to the definitions of "income tax" in the now repealed sections CZ 5, KF 1, and KF 2.

Clause 26 amends section OD 8, which defines associated persons for certain purposes, to provide that the definition generally applicable in the international tax rules also applies for the purposes of the new transfer pricing regime in *section GD 13* and the new thin capitalisation regime in *Part FG*.

The amendments also remove cross-references to section LE 1, which has been repealed and replaced by the new *Part LE*.

Clause 27 amends section OF 2, which provides for references to income years in certain provisions to be read as references to the equivalent accounting year, to apply that provision to the new thin capitalisation regime in the new *Part FG* and the amended foreign investor tax credit regime in the new *Part LE*, and to remove a reference to the now repealed section OB 5.

Clause 28 amends Schedule 1 to the principal Act to reduce from 38% to 33% the tax on non-resident companies.

PART II

TAX ADMINISTRATION

This Part amends the Tax Administration Act 1994.

Clause 30 inserts a new *section 90A* into the Act. The new section permits the Commissioner to issue determinations for the purposes of the thin capitalisation regime in the new *Part FG* of the Income Tax Act 1994 with regard to the question of whether any financial arrangement provides funds to the issuer and is accordingly required to be taken into account in calculating, for the purposes of that regime, a taxpayer's New Zealand group debt percentage. The new section is based upon section 90, which deals with determinations in relation to financial arrangements for the purposes of the accruals regime.

Clause 31 amends section 91E of the Act, which empowers the Commissioner to make private rulings on request, to specify that the Commissioner may make private rulings for the purposes of the new apportionment rule in section FB 2 and transfer pricing regime in *section GD 13*, notwithstanding that the ruling requires the Commissioner to determine questions of fact.

Clause 32 amends section 92 of the Act, which relates to assessments and determinations, to remove references to section GC 1 of the Income Tax Act 1994. These references are no longer necessary for the new *section GC 1* substituted by *clause 10* of the Bill.

Hon. Wyatt Creech

TAXATION (INTERNATIONAL TAX)

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A BILL INTITULED

An Act to amend the international tax regime

BE IT ENACTED by the Parliament of New Zealand as follows:

1. Short Title—This Act may be cited as the Taxation (International Tax) Act **1995**. 5

PART I

INCOME TAX

2. Part to be read with Income Tax Act 1994—(1) This Part of this Act shall be read together with and deemed part of the Income Tax Act 1994* (in this Part referred to as the 10 principal Act).

(2) Except as otherwise provided in this Part, this Part applies with respect to the tax on income derived in the 1996–97 income year and subsequent years.

3. Meaning of term "dividends"—(1) Section CF 2 (8) of 15 the principal Act is amended by omitting from paragraph (a)(i) the expression "section LE 1 (2)", and substituting the expression "**section LE 2 (5) and (6)**".

(2) This section applies with respect to dividends paid on or after the day on which this Act receives the Royal assent. 20

4. Branch equivalent income calculation—(1) Section CG 11 (6) of the principal Act is amended by inserting, after paragraph (b), the following paragraph:

"(ba) **Part FG**:".

(2) Section CG 11 is further amended by repealing 25 subsection (8), and substituting the following subsection:

"(8) Where a transaction has been entered into between a controlled foreign company and any person associated with the controlled foreign company, which has a purpose or effect of defeating the intent and application of any of the 30 jurisdictional ring-fencing rules in sections IE 3, IG 4, LC 4 and LC 5, **section GD 13** shall apply with any necessary modifications in determining the branch equivalent income or branch equivalent loss of the controlled foreign company; and for the purposes of this subsection a person and a controlled foreign 35 company shall be treated as associated if they would be treated as so associated by virtue of any of the provisions of section OD 7 or section OD 8 (3)."

*1994, No. 164
Amendments: 1995, No. 18; 1995, No. 21

5. Insurance with persons not carrying on business in New Zealand—Section CN 4 (1) of the principal Act is amended by omitting the words "not deemed to be resident in New Zealand, expressed as a percentage, stated in clause 6", and substituting the words ", expressed as a percentage, stated in **clause 5**".

6. Partial exemption of certain life insurance companies in respect of interest derived from certain debentures—The principal Act is amended by repealing section CZ 5.

7. Non-resident mining operators—Section DN 5 (2) of the principal Act is amended by omitting the words "and to clause 6 of Part A of Schedule 1".

8. Apportionment of income derived partly in New Zealand and partly elsewhere—Section FB 2 of the principal Act is amended by repealing subsection (1), and substituting the following subsections:

"(1) For the purposes of this Act generally, if—

"(a) Any business of a taxpayer is carried out partly in New Zealand and partly outside New Zealand; or

"(b) A contract is made in New Zealand and is wholly or partly performed by a taxpayer outside New Zealand, or is made outside New Zealand and is wholly or partly performed by a taxpayer in New Zealand,—

the gross amount of income from the business or contract, and expenditure incurred in gaining or producing the income, will be apportioned to New Zealand in such a way and to such an extent as is necessary to produce an amount of net income or net loss for the purposes of this Act in respect of the business or contract which the taxpayer might be expected to derive if the taxpayer's activities in New Zealand in respect of the business or contract were carried out by the taxpayer as a separate and wholly independent person undertaking only those activities and dealing at arm's length.

"(1A) For the purposes of Part L, if—

"(a) Any business of a taxpayer is carried on partly in one country and partly in another country; or

"(b) A contract is made in one country and wholly or partly performed by a taxpayer in another country, or is partly performed by a taxpayer in 2 or more countries,—

the gross amount of income from the business or contract, and expenditure incurred in gaining or producing the income, will be apportioned between the countries in such a way and to such an extent as is necessary to produce an amount of net income or net loss, in respect of each country and the business or contract, which the taxpayer might be expected to derive if the taxpayer's activities in that country in respect of the business or contract were carried out by the taxpayer as a separate and wholly independent person undertaking only those activities and dealing at arm's length.

"(1B) If an apportionment is made under **subsection (1) or subsection (1A)**, the taxpayer will be assessable for income tax accordingly."

9. New Subpart inserted—The principal Act is amended by inserting, after Part FF, the following Subpart:

"SUBPART G—APPORTIONMENT OF INTEREST COSTS

"FG 1. **Purpose of this Subpart**—Subject always to the express provisions of this Subpart, the purpose of this Subpart is to ensure, in the case of a New Zealand taxpayer controlled by a single non-resident and which has a disproportionately high level of New Zealand group debt funding, an appropriate apportionment to the New Zealand taxpayer of the worldwide interest expenditure of the group of entities of which the New Zealand taxpayer is a part.

"FG 2. **Entities to which apportionment rule potentially applies**—(1) The interest apportionment rule in **section FG 8** can apply only if, at any time in the relevant income year, the taxpayer is—

"(a) Not resident in New Zealand; or

"(b) A company controlled by a single person not resident in New Zealand; or

"(c) The trustee of a non-qualifying trust 50% or more settled by a single person not resident in New Zealand.

"(2) For the purposes of this section, a taxpayer company will be treated as being controlled by a single person at any time if the group comprising the single person and all persons associated with the single person has—

"(a) 50% or greater voting interests in the company; or

"(b) 50% percent or greater market value interests in the company, in any case where a market value circumstance exists at the time; or

"(c) Control of the company by any other means whatsoever.

"(3) For the purposes of **subsection (2)** when calculating the voting interest or market value interest of a company in a taxpayer company, the look through rules in section OD 3 (3)(d) and OD 4 (3)(d) will not apply to the extent that application of those rules would result in the taxpayer company, which would otherwise be treated as being controlled by a single person not resident in New Zealand, ceasing to be so treated.

"(4) For the purposes of this section, a trust will be treated as being 50% or more settled by a single person if the value of settlements by the single person, when aggregated with the value of settlements by all the persons associated with the single person, aggregate to 50% or more of the total value of all settlements on the trust.

"(5) For the purposes of this section, a foreign company will be treated as not being resident in New Zealand.

"FG 3. **Circumstances in which apportionment required**—**Section FG 8** will apply to require an apportionment of interest deductions for an income year if the taxpayer has a New Zealand group debt percentage for the income year which exceeds both—

"(a) 75%; and

"(b) The worldwide group debt percentage of the taxpayer multiplied by 1.1.

"FG 4. **Rules for calculating New Zealand group debt percentage**—(1) The New Zealand group debt percentage will be the percentage which the amount of total debt represents of the amount of total assets for the taxpayer's New Zealand group for the income year, and must be calculated under the rules in this section.

"(2) Total debt means the aggregate of the outstanding balances on the relevant date chosen under **subsection (3)** of all financial arrangements issued by the taxpayer (or another group member) if—

"(a) The financial arrangement provides funds to the issuer; and

"(b) The issuer can claim a deduction in calculating its assessable income in respect of the financial arrangement, otherwise than a deduction solely attributable to a movement in currency exchange rates.

"(3) The amount of total debt for the income year must be measured, at the election of the taxpayer, on the basis of—

"(a) An average of the figures for the amount of total debt calculated at the end of each day of the income year; or

"(b) An average of the figures for the amount of total debt calculated at the end of each complete consecutive 3-month period during the income year; or

"(c) The highest amount of total debt calculated at any time during the income year.

"(4) Total assets for the income year means total assets at the end of the income year, which (subject to the following subsections) must be measured, at the election of the taxpayer, by—

"(a) The values shown in the financial accounts of the taxpayer's New Zealand group; or

"(b) The market value of the assets; or

"(c) If permitted under generally accepted accounting principles of New Zealand, a combination of the financial account values and market values.

"(5) Notwithstanding **subsection (4)**, if the taxpayer (or any other person included in the taxpayer's group under **subsection (9) or subsection (10)**) is a company liquidated during the income year, the total assets will include the highest amount of total assets of that company calculated at any time during the income year (excluding any assets held at the end of the income year by another group member).

"(6) The amount of total assets must be calculated under generally accepted accounting principles of New Zealand.

"(7) The amount of total debt and the amount of total assets calculated must be in New Zealand currency and, subject to **section FG 7**, any necessary currency conversions must be made at the close of trading spot exchange rate on the date as at which the amount is being calculated.

"(8) Any temporary reduction in the amount of total debt and any temporary increase in the amount of total assets must be excluded from the calculations if the reduction or increase has a purpose or effect of defeating the intent and application of this Subpart.

"(9) If the taxpayer is a company, the amount of total debt and the amount of total assets must be calculated, on a consolidated basis for elimination of intra-group balances used under generally accepted accounting principles of New Zealand for consolidation of a group of companies, for the group comprising the taxpayer and all companies which are—

"(a) Resident in New Zealand or carrying on business in New Zealand through a fixed establishment in New Zealand; and

"(b) At the election of the taxpayer,—

5 "(i) Required to be included in consolidated group accounts with the taxpayer under generally accepted accounting principles of New Zealand; or

"(ii) Members of the same group of companies as the taxpayer.

10 "(10) If the taxpayer is an individual or a trustee, the amount of total debt and the amount of total assets must be calculated, on a consolidated basis for elimination of intra-group balances equivalent to that used for consolidation of a group of companies under generally accepted accounting 15 principles of New Zealand, for the group comprising the taxpayer and all associated persons which are—

"(a) Resident in New Zealand; or

"(b) Carrying on business in New Zealand through a fixed establishment in New Zealand.

20 "(11) In any case where a group member required to be included in the consolidated calculation under **subsection (9) or subsection (10)** is not resident in New Zealand, the amount of total debt and amount of total assets will only include the total debt and total assets of that group member to the extent that that 25 group member is carrying on business in New Zealand through a fixed establishment in New Zealand.

"(12) If the taxpayer is an individual, total assets will not include any private or domestic assets.

"FG 5. **Rules for calculating worldwide group debt** 30 **percentage**—(1) The worldwide group debt percentage will be the percentage which the amount of total debt represents of the amount of total assets for the taxpayer's worldwide group for the accounting year of the member of the group which has the highest amount of total assets of all persons in the group 35 ending most immediately prior to the start of the income year, and must be calculated under the rules in this section.

"(2) Subject to the following subsections, either or both the amount of total debt and the amount of total assets can be taken from the financial accounts of the taxpayer's worldwide 40 group.

"(3) The amount of total debt and amount of total assets for the income year will be measured at the end of the relevant accounting year.

"(4) Notwithstanding **subsection (3)**, if the taxpayer (or any other person included in the taxpayer's group under **subsection (9) or subsection (10)**) is a company liquidated during the income year, the total assets will include the highest amount of total assets of that company calculated at any time during the income year (excluding any assets held at the end of the income year by another group member). 5

"(5) The amount of total debt and amount of total assets must be calculated under generally accepted accounting principles of New Zealand (or, at the election of the taxpayer, an equivalent standard for financial reporting in a consistent and non-distorting manner of a country or territory in which is resident the group member which has the highest amount of total assets of all persons in the group). 10

"(6) Notwithstanding **subsections (3) and (5)**, the taxpayer may elect either or both— 15

"(a) To measure total debt applying the definition of total debt in **section FG 4 (2)** (applying that provision as if **paragraph (b)** referred also to a deduction which could be claimed if the issuer was resident in New Zealand): 20

"(b) To measure total debt on one of the bases listed in **section FG 4 (3)** (applying that provision as if the accounting year were the income year referred to).

"(7) The amount of total debt and total assets calculated must be in New Zealand currency and, subject to **section FG 7**, any necessary currency conversions must be made at the close of trading spot exchange rate on the date as at which the amount is being calculated. 25

"(8) Any temporary reduction in the amount of total debt and any temporary increase in the amount of total assets must be excluded from the calculations if the reduction or increase has a purpose or effect of defeating the intent and application of this Subpart. 30

"(9) If the taxpayer is a company, the amount of total debt and the amount of total assets must be calculated, on a consolidated basis for elimination of intra-group balances used under generally accepted accounting principles of New Zealand (or, at the election of the taxpayer, an equivalent standard for financial reporting in a consistent and non-distorting manner of another country in which is resident the group member which has the highest amount of total assets of all companies in the group) for consolidation of a group of companies, for the group comprising the taxpayer and all companies required to be included in consolidated group 35 40 45

accounts with the taxpayer under those generally accepted accounting principles (or the chosen equivalent standard).

"(10) If the taxpayer is an individual or a trustee, the amount of total debt and total assets must be calculated, on a consolidated basis for elimination of intra-group balances equivalent to that used for consolidation of companies under generally accepted accounting principles of New Zealand, for the group comprising the taxpayer and all associated persons.

"(11) If the taxpayer is an individual, total assets will not include any private or domestic assets and total debt will not include any debt incurred to acquire private or domestic assets.

"(12) If it is impractical for the taxpayer to calculate the taxpayer's worldwide group debt percentage for an income year due to an inability to comply with all or any of these rules,—

"(a) The taxpayer may elect that the Commissioner must estimate the percentage in accordance with the intent of this Subpart and, if the Commissioner then makes an estimate, the estimate will be treated as being the percentage for the purposes of this Subpart; and

"(b) If the Commissioner is not asked to or cannot reasonably make an estimate, this Subpart will apply as if the percentage was 68.1818.

"FG 6. **Concession for on-lending**—(1) If the taxpayer (or another group member) is the holder of a financial arrangement issued by—

"(a) A person not associated with the taxpayer; or

"(b) A person who is neither resident in New Zealand nor carrying on business in New Zealand through a fixed establishment in New Zealand,—

in calculating the taxpayer's New Zealand group debt percentage, the amount of total debt at the time and the amount of total assets at the time must be reduced by an amount equal to the outstanding balance of the financial arrangement.

"(2) **Subsection (1)** will not apply in the case of a financial arrangement excluded from total debt for the taxpayer's New Zealand group under **section FG 4 (2)**.

"(3) If the taxpayer (or another group member) is the holder of a financial arrangement issued by a person not associated with the taxpayer, in calculating the taxpayer's worldwide group debt percentage the amount of total debt at the time and the amount of total assets at the time must be reduced by

an amount equal to the outstanding balance of the financial arrangement.

"FG 7. **Concession for exchange rate fluctuations**—The taxpayer may elect, when calculating the taxpayer's New Zealand or worldwide group debt percentage for the income year, to calculate the outstanding balance of any one or more financial arrangements, or the value of any one or more assets, denominated in a currency other than New Zealand currency using the forward exchange rate, for the relevant measurement date specified in **section FG 4 or section FG 5**, applicable on the first day of the income year.

"FG 8. **Apportionment of interest deductions**—(1) Notwithstanding anything in section DD 1 (b), if a taxpayer's New Zealand group debt percentage for an income year fails the test in **section FG 3**, the amount deductible by the taxpayer in the income year under section DD 1 (b) will be reduced by the amount calculated as follows:

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

where—

"I is the amount which would have been deductible by the taxpayer under section DD 1 (b) but for this Subpart; and

"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 (9) or section FG 4 (10)**; and

"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)**; and

"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**; and

"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 (which amount must be averaged in circumstances where **section FG 4 (3) (a) or section FG 4 (3) (b)** applies); and

"NZDP is the taxpayer's New Zealand group debt percentage for the income year; and

"WWDP is the greater of—

"(a) 75 percent; and

"(b) The taxpayer's worldwide group debt per centage for the income year multiplied by 1.1.

"(2) Notwithstanding **subsection (1)**, if and to the extent that another member of the same wholly-owned group of companies so elects and has a sufficient deductible amount so to be reduced (after allowing for any other reductions under this subsection), the reduction will be made to the amount deductible by the other group member under section DD 1 (b) for the income year instead of to the amount deductible by the taxpayer.

"FG 9. **Mode of elections**—(1) Any election available to a person under this Subpart must be exercised by the person filing accordingly the person's return of income for the income year.

"(2) Notwithstanding **subsection (1)**, any election under **section FG 4 (3) or section FG 5 (6)(b)** can be revoked and exercised differently on receipt of an assessment from the Commissioner for the relevant income year."

10. Arrangement to defeat application of cross-border arrangement provision—The principal Act is amended by repealing section GC 1, and substituting the following section—

"GC 1. Notwithstanding **section GD 13 (2)**, **section GD 13** will also apply to require the substitution of an arm's length amount of consideration in the case of an arrangement which has a purpose or effect in respect of any taxpayer of defeating the intent and application of that section (including, but without limiting the generality of this section, as a result of a collateral arrangement involving an associated person not resident in New Zealand, or another collateral arrangement such as a market sharing arrangement, an arrangement not to enter a particular market, a back-to-back supply arrangement, or an income sharing arrangement)."

11. Arrangement to defeat application of non-resident portfolio investor provisions—(1) The principal Act is amended by repealing section GC 13.

(2) This section applies with respect to dividends paid on or after the day on which this Act receives the Royal assent.

12. Cross-border arrangements between associated persons—The principal Act is amended by inserting, after section GD 12, the following section:

"GD 13. (1) Subject always to its express provisions, the purpose of this section is to require a taxpayer, who enters into a cross-border arrangement with an associated person for the acquisition or supply of goods, services, or anything else at a consideration which reduces the taxpayer's net income, to substitute an arm's length consideration when calculating the taxpayer's net income.

"(2) This section will only apply to require the substitution of an arm's length amount of consideration in the case of an arrangement—

"(a) Which involves the supply and acquisition of goods, services, money, other intangible property, or anything else; and

"(b) Where the supplier and acquirer are associated persons; and

"(c) Where the supplier and acquirer are—

"(i) Two persons each not resident in New Zealand (unless each enters into the arrangement for the purposes of a business carried on by the person in New Zealand through a fixed establishment in New Zealand); or

"(ii) A person resident in New Zealand and a person not resident in New Zealand (unless the non-resident is entering into the arrangement for the purposes of a business carried on by the non-resident in New Zealand through a fixed establishment in New Zealand); or

"(iii) Two persons each resident in New Zealand if either or both enter into the arrangement for the purposes of a business carried on by the person outside New Zealand.

"(3) If the amount of consideration payable by a taxpayer under such an arrangement exceeds the arm's length amount, then for all purposes of the application of this Act in relation to the income tax liability of the taxpayer, an amount equal to the arm's length amount will be deemed to be the amount payable by the taxpayer in substitution for the actual amount.

"(4) If the amount of consideration receivable by a taxpayer under such an arrangement is less than the arm's length amount, then for all purposes of the application of this Act in relation to the income tax liability of the taxpayer or to the obligation of any other person to make a withholding or

deduction from the amount under Part N, an amount equal to the arm's length amount will be deemed to be the amount receivable by the taxpayer in substitution for the actual amount.

5 "(5) **Subsection (4)** will not apply if—

"(a) The taxpayer is neither resident in New Zealand nor entering into the arrangement for the purposes of a business carried on in New Zealand through a fixed establishment in New Zealand; and

10 "(b) The amount is interest, royalties, or an insurance premium; and

"(c) The amount is deductible in calculating the net income of the other party.

"(6) For the purposes of this section, the arm's length 15 amount of consideration must be determined by applying whichever one (or combination) of the methods listed in **subsection (7)** will produce the most reliable measure of the amount completely independent parties would have agreed upon after real and fully adequate bargaining.

20 "(7) The arm's length amount of consideration must be calculated under any one (or a combination) of—

"(a) The comparable uncontrolled price method; or

"(b) The resale price method; or

"(c) The cost plus method; or

25 "(d) The profit split method; or

"(e) Comparable profits methods.

"(8) The choice of method or methods for calculation and the resultant application of the method (or methods) must be made having regard to—

30 "(a) The degree of comparability between the uncontrolled transactions used for comparison and the controlled transactions of the taxpayer; and

"(b) The completeness and accuracy of the data relied on; and

35 "(c) The reliability of all assumptions; and

"(d) The sensitivity of any results to possible deficiencies in the data and assumptions.

"(9) The arm's length amount of consideration will be determined by the taxpayer under **subsections (6) to (8)**, and the 40 amount so determined will be the arm's length amount for the purposes of **subsections (3), (4), and (10)**, unless—

"(a) The Commissioner can demonstrate another amount to be a more reliable measure of the arm's length amount; or

"(b) The taxpayer has not co-operated with the Commissioner in the Commissioner's administration of this section in relation to that taxpayer and the nonco-operation has materially affected the Commissioner in that administration,— 5

in either of which events the Commissioner will determine the amount under **subsections (6) to (8)** for the purposes of **subsections (3), (4), and (10)**.

"(10) If—

"(a) The amount of consideration payable by a taxpayer for an acquisition is less than an arm's length amount or the amount of consideration receivable by the taxpayer for a supply exceeds an arm's length amount (that acquisition or supply being referred to in this subsection as the compensating adjustment arrangement); and 10 15

"(b) In the same income year, either—

"(i) An amount of consideration payable by the taxpayer is adjusted down under **subsection (3)**; or

"(ii) An amount of consideration receivable by the taxpayer is adjusted up under **subsection (4)**; and 20

"(c) The adjustment down (or up) is in respect of an arrangement for acquisition (or supply) with the same other party and—

"(i) Involving goods, services, money, other intangible property, or anything else of the same type as that supplied and acquired in the compensating adjustment arrangement; or 25

"(ii) Where the amount of consideration actually payable (or receivable) is set having regard to the amount of consideration actually payable (or receivable) under the compensating adjustment arrangement,— 30

then for all purposes of the application of this Act in relation to income tax liability of the taxpayer (or, if the amount is receivable by the taxpayer, to the obligation of any other person to make a withholding or deduction from the amount under Part N), an amount equal to the arm's length amount will be deemed to be the amount payable (or receivable) by the taxpayer under the compensation adjustment arrangement in substitution for the actual amount. 35 40

"(11) If—

"(a) An arm's length amount of consideration is substituted under **subsection (3)** or **subsection (4)** in respect of an arrangement entered into by a taxpayer; and 45

"(b) The other party to the arrangement applies to the Commissioner in writing within 2 months after the taxpayer has first received an assessment or determination from the Commissioner which reflects the substitution; and

"(c) The Commissioner considers it is fair and reasonable to do so, having regard to any adjustment made under a double tax agreement or any other matter, and has notified the other party in writing,—

then the substitution will so apply for all purposes of the application of this Act in relation to the other party, except for determining whether and the extent to which the other party has derived or been paid a dividend.

"(12) Except to the extent that **subsection (11)** applies, an adjustment under any of **subsections (3), (4)**, and **(10)** will have no effect on any liability of the taxpayer to make a withholding or deduction in respect of the amount under Part N.

"(13) In this section,—

" 'Acquisition'—

"(a) Subject to **paragraph (b)**, includes obtaining the availability of any thing; and

"(b) Does not include the mere receipt, or retention, by a company of consideration for issue of a share (unless the share is a fixed rate share):

" 'Amount' includes a nil amount:

" 'Supply'—

"(a) Subject to **paragraph (b)**, includes making any thing available; and

"(b) Does not include the mere payment, and subsequent continuing making available, by a person to a company of consideration for issue of a share (unless the share is a fixed rate share)."

13. Removal of rebates for non-resident companies—The principal Act is amended by repealing sections KF 1 and KF 2.

14. Continuation of rebates in respect of certain specified development projects—The principal Act is amended by inserting, after section KZ 2, the following section:

"KZ 3. (1) Notwithstanding the repeal of sections KF 1, NF 1 (2)(a)(vi), NG 1 (2)(f), and OB 5 of this Act by **sections 13, 19, 20, and 24** of the **Taxation (International Tax) Act 1995**, a non-resident investment company shall, in relation to the development projects specified in **subsection (2)** of this section continue to be

eligible for the rebates specified in subsections (2) and (3) of section KF 1 of this Act as if those subsections had not been repealed, and, accordingly,—

"(a) Sections NF 1 (2)(a)(vi) and NG 1 (2)(f) shall continue to apply in respect of the company; and 5

"(b) Section OB 5 and the definitions of any terms relevant to those rebates shall be treated as continuing in force for the purposes of this section.

"(2) This section applies to the development projects specified in the following orders: 10

"(a) The Income Tax (Non-Resident Investment Companies) Order 1970 (S.R. 1970/138):

"(b) The Income Tax (Non-Resident Investment Companies) Order 1972 (S.R. 1972/19):

"(c) The Income Tax (Non-Resident Investment Companies) Order (No. 2) 1972 (S.R. 1972/248): 15

"(d) The Income Tax (Non-Resident Investment Companies) Order (No. 3) 1974 (S.R. 1974/277)."

15. Resident withholding tax deductions to be credited against income tax assessed—(1) Section LD 3 (3) of the 20 principal Act is amended by omitting the expression "sections LB 2, LC 1, and LE 1", and substituting the expression "sections LB 2 and LC 1 and **Part LE**".

(2) This section applies with respect to dividends paid on or after the day on which this Act receives the Royal assent. 25

16. Credits in respect of dividends to non-resident portfolio investors—(1) The principal Act is amended by repealing Part LE, and substituting the following Subpart:

"SUBPART E—NON-RESIDENT INVESTORS

"LE 1. **Purpose of Subpart**—Subject always to its express 30 provisions, the purpose of this Subpart is to allow a company, which pays to a non-resident investor a dividend with an imputation credit attached, and a supplementary dividend to the same investor, to claim an income tax credit calculated by reference to the imputation credit which is equal to and 35 sufficient to fund the supplementary dividend.

"LE 2. **Credits in respect of dividends to non-resident investors**—(1) This section applies if a company resident in New Zealand pays in any income year with respect to its own shares— 40

"(a) A dividend (referred to in this section as the dividend); and

"(b) A single supplementary dividend with respect to the dividend,—

derived by a person not resident in New Zealand.

"(2) The company will be entitled under this section to a credit against payment of its income tax calculated by multiplying, by 0.5583, the imputation credit (if any, and calculated having regard to **subsections (8) and (9)**) attached to the dividend.

"(3) The tax credit will be allowed only against the income tax payable—

"(a) After allowing for any credit under section LC 1; and

"(b) Before allowing for any credit under section LB 2 or section LD 3.

"(4) The tax credit will be allowed in the first instance against income tax payable by the company for the income year.

"(5) If the amount of tax credit exceeds the income tax payable (after allowing for any credit under section LC 1 and before allowing for any credit under section LB 2 or section LD 3) by the company in respect of the income year, the company may elect under **subsection (6)** that the excess credit be credited (so far as it extends) in payment of other income tax of the company or the income tax of another company.

"(6) The company must make such an election by notice in writing to the Commissioner with the company's return of income for the income year and the election can only be made in the case of income tax payable—

"(a) In respect of the income year, by any other company which is for the income year (or in any case where one of the companies exists for part only of the income year, at all times in the income year at which the 2 companies both exist) in the same wholly-owned group of companies as the company; or

"(b) In respect of any of the 4 income years immediately preceding the income year (being in each case the 1993–94 income year or a subsequent income year), by—

"(i) The company; or

"(ii) Any other company which is, for both the income year and the relevant preceding income year (or, in any case where one of the companies exists for part only of the relevant income year, at all times in the relevant income year at which the 2 companies both exist) in the same wholly-owned group of companies as the company.

"(7) If and to the extent that the company so elects, the excess credit shall be so credited and shall cease to be available otherwise to be credited under this section.

"(8) The benchmark dividend provisions of sections ME 8 and MG 8 and the provisions of section GC 22 will apply as if the company had never paid the supplementary dividend. 5

"(9) The maximum imputation credit ratio and benchmark dividend provisions of section ME 8 and the provisions of section GC 22 will apply as if the imputation credit attached to the dividend were increased by an amount equal to the tax credit calculated with respect to the dividend under **subsection (2)**. 10

"(10) If the company pays such a supplementary dividend with respect to all shares of the relevant class held by persons not resident in New Zealand, the payment of the supplementary dividend with respect only to certain shares of that class will not be treated as contravening— 15

"(a) Any provision of the Companies Act 1955, or section 53 of the Companies Act 1993; or

"(b) Any provision of the company's articles of association or constitution (not being a provision which expressly refers to this subsection); or 20

"(c) Any rule of law—

which would otherwise prohibit the payment by the company at the time of dividends of different amounts in relation to shares of the class. 25

"(11) If a trustee derives the dividend and is required under the terms of the trust to distribute it as beneficiary income to a beneficiary, the distribution by the trustee of the supplementary dividend to the same beneficiary will not be treated as contravening any term of the trust. 30

"LE 3. **Special rules for holding companies**—(1) **Subsections (4) to (9)** apply if a company (referred to in this section as the company) resident in New Zealand pays in any income year with respect to its own shares—

"(a) A dividend (referred to in this section as the dividend); and 35

"(b) A single supplementary dividend with respect to the dividend,—

derived by a **section LE 3** holding company.

"(2) A **section LE 3** holding company is a company resident in New Zealand which has given notice to the company which complies with **subsection (3)**. 40

"(3) The **section LE 3** holding company can give such a notice only if—

"(a) It is made in writing before the start of the income year in which the dividend is paid and relates to that year; and

"(b) At the time the notice is given—

5 "(i) If the **section LE 3** holding company and the company are associated persons (as defined in section OD 8 (3) but as if each reference in that provision to "50% or more" instead read "more than 50%"), the 2 companies have the same balance 10 date; and

"(ii) At least one person not resident in New Zealand has a voting interest in the **section LE 3** holding company; and

"(iii) The **section LE 3** holding company is not 15 exempt from income tax, except under section CB 10 (2); and

"(iv) The **section LE 3** holding company has the purpose in giving the notice of enabling, directly or indirectly, the payment of a supplementary 20 dividend to a person not resident in New Zealand; and

"(v) The **section LE 3** holding company has a reasonable expectation that its income tax liability for an income year, before allowing for any 25 application of this Subpart, will be less than the amount of the supplementary dividends it intends to pay in the income year.

"(4) **Section LE 2** will apply as if the **section LE 3** holding company were not resident in New Zealand.

30 "(5) The dividend will not be exempt from tax under section CB 10 (2) except to the extent to which it exceeds the amount calculated under the following formula:

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

35 where—

"IC is the amount of imputation credit attached to the dividend; and

"SD is the amount of the supplementary dividend; and

"T is the rate of resident companies' tax, expressed as a 40 percentage, stated in clause 5 of Part A of Schedule 1 and applying in respect of the income year,—

and the imputation credit will be deemed, for the purposes of section LB 2, to be included in the part of the dividend which is not exempt.

"(6) The dividend will be ignored for the purposes of the RWT rules to the extent to which it does not exceed the amount calculated under the formula in **subsection (5)**, and the imputation credit will be deemed to be included in the part ignored. 5

"(7) The supplementary dividend will not be exempt from tax under section CB 10 (2).

"(8) The supplementary dividend will be ignored for the purposes of the RWT rules.

"(9) Notwithstanding any other provision of this Act, the 10 income tax liability of the **section LE 3** holding company for the income year, before allowing for any credits under **section LE 2** but after allowing for any other credits under this Part, will be at least equal to the amount of all supplementary dividends derived by the **section LE 3** holding company in the income year 15 and the **section LE 3** holding company will be assessable accordingly.

"(10) If and to the extent **subsection (9)** applies to require payment of an additional amount of tax, the **section LE 3** holding company will be deemed to have incurred, on the date on 20 which the tax is paid, an amount of loss for the relevant income year equal to the tax amount divided by the rate of resident companies' tax, expressed as a percentage, stated in clause 5 of Part A of Schedule 1 and applying for the income year." 25

(2) This section applies with respect to dividends paid on or after the day on which this Act receives the Royal assent.

17. Credits arising to imputation credit account—(1) Section ME 4 (1)(a)(v) of the principal Act is amended by omitting the expression "section LE 1" and substituting the 30 expression "**Part LE**".

(2) This section applies with respect to dividends paid on or after the day on which this Act receives the Royal assent.

18. Company may attach imputation credit to dividend—The principal Act is amended by repealing 35 section ME 6 and substituting the following section—

"ME 6. (1) An imputation credit account company may, on payment of a dividend by the company, attach an imputation credit to that dividend.

"(2) Notwithstanding **subsection (1)**, if— 40

"(a) An imputation credit account company pays a non-cash dividend; and

"(b) The company is subject to an adjustment under **section GD 13 (3)** or **section GD 13 (4)** in respect of the arrangement giving rise to the dividend,—

the company may retrospectively attach an imputation credit to the dividend, subject to compliance with **subsections (3)** and **(4)** of this section.

"(3) The amount of imputation credit able to be attached retrospectively under **subsection (2)** must not (when aggregated with all other imputation credits retrospectively attached by the company to dividends paid in the same imputation year) exceed the least of—

"(a) The credit balance, if any, in the company's imputation credit account at the end of the imputation year in which the dividend is paid; and

"(b) The credit balances, if any, in the company's imputation credit account at the end of each imputation year after the year in which the dividend is paid and before the year in which the company makes the retrospective attachment.

"(4) Where a company has determined that an imputation credit will be attached to a dividend under **subsection (2)**,—

"(a) The amount of the imputation credit will, for the purposes of section ME 5, be a debit to the company's imputation credit account arising on the date the company paid the dividend; and

"(b) The company dividend statement to be completed in accordance with section 67 of the Tax Administration Act 1994 must be completed at the time the company makes the determination under **subsection (2)** of this section; and

"(c) The shareholder dividend statement to be given by the company in accordance with section 29 of the Tax Administration Act 1994 must be given at the time the company makes the determination under **subsection (2)** of this section.

19. Application of RWT rules—Section NF 1 (2)(a) of the principal Act is amended by repealing subparagraph (vi).

20. Application of NRWT rules—(1) Section NG 1 (2) of the principal Act is amended by inserting, after paragraph (e), the following paragraph:

"(ea) Derived by a life insurer from a company resident in New Zealand deemed to exist as a result of the life insurer making an election under section OE 3; or".

(2) Section NG 1 (2) is further amended by repealing paragraph (f) (and also the expression "; or" at the end of **paragraph (ea)**).

(3) **Subsection (1)** of this section applies with respect to non-resident withholding income paid on or after the day on which this Act receives the Royal assent. 5

21. Non-resident withholding tax imposed—(1) The principal Act is amended by repealing section NG 2, and substituting the following section:

"NG 2. (1) Every person who derives non-resident withholding income shall be liable to pay non-resident withholding tax upon that income— 10

"(a) At the rate of 30% of the gross amount of so much of that income as consists of dividends (other than investment society dividends, or supplementary dividends payable as a result of **Part LE**) to the extent the dividends are not fully imputed. 15

"(b) At the rate of zero percent of the gross amount of so much of that income as consists of—

"(i) Interest paid by an approved issuer in respect of a registered security and derived by a person who is not an associated person of the approved issuer; or 20

"(ii) Non-cash dividends to the extent fully imputed: 25

"(c) At the rate of 15% of the gross amount of so much of that income as consists of income to which neither **paragraph (a)** nor **paragraph (b)** applies.

"(2) Every person liable under **subsection (1)** to pay an amount of non-resident withholding tax in respect of non-resident withholding income consisting of dividends shall be deemed to have paid the non-resident withholding tax to the extent of any dividend withholding payment credit that is included within the non-resident withholding income. 30

"(3) For the purposes of this section, the extent to which any dividends are fully imputed must be calculated under the following formula: 35

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

where— 40

"IC is the amount of imputation credits attached to the dividends; and

"SD is the amount of supplementary dividends payable as a result of **Part LE** in respect of the dividends; and

"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."

(2) This section applies with respect to non-resident withholding income paid on or after the day on which this Act receives the Royal assent.

22. Non-resident withholding tax to be final tax in certain cases—Section NG 3 of the principal Act is amended by omitting the words ", subject to section KF 1,".

23. Definitions—(1) The definition of the term "accounting year" in section OB 1 of the principal Act is amended—

(a) By omitting from paragraph (a) the words "Subject to paragraph (c),":

(b) By further omitting from paragraph (a) the words "and section KF 2":

(c) By repealing paragraph (c).

(2) Section OB 1 is further amended by inserting, after the definition of the term "accruals rules", the following definition:

" 'Acquisition' is defined in **section GD 13 (13)** for the purposes of that section:".

(3) Section OB 1 is further amended by repealing paragraph (b) of the definition of the term "amount".

(4) The definition of the term "amount" is further amended by adding the following paragraph:

"(c) Is defined in **section GD 13 (13)** for the purposes of that section:".

(5) Section OB 1 is further amended by omitting from paragraph (d) of the definition of the term "associated person" the expression "HK 11 (10), and LE 1", and substituting the expression "and HK 11 (10)".

(6) Section OB 1 is further amended by repealing the definitions of the terms "branch" and "development investments".

(7) The definition of the term "dividend" in section OB 1 is amended—

(a) By omitting from paragraph (a) the words "paragraphs (b) to (f)", and substituting the words "paragraphs (b) to (e)":

(b) By omitting from paragraph (b) of the definition of the term "dividend" the words "and in section LE 1":

(c) By inserting in that definition, after paragraph (b), the following paragraph:

"(ba) In **Part LE**— 5

"(i) Includes in any case where—

"(A) An amount is paid by a company (in this subparagraph referred to as the first company) to a shareholder being a company (in this subparagraph referred 10 to as the second company); and

"(B) The second company would at that time, by virtue of the provisions of section CF 3 (12) if the first company were a specified company, be a person 15 related to that first company,—

that amount to the extent that it would be treated as a dividend derived by the second company in respect of a share or shares in the first company upon 20 liquidation of the first company if, and only if, in applying section CF 3 (1)(c) to the liquidation, the excess return amount in respect of each share were nil:

"(ii) Does not include— 25

"(A) Any non-cash dividend; or

"(B) Any dividend derived by a life insurer from a company resident in New Zealand deemed to exist as a result of the life insurer making an election under 30 section OE 3:":

(d) By repealing paragraph (f).

(8) Section OB 1 is further amended by repealing the definition of the term "dividend withholding payment portion". 35

(9) Section OB 1 is further amended by repealing the definitions of the terms "effective rate of domestic tax" and "first specified period".

(10) Section OB 1 is further amended by omitting from paragraph (a) of the definition of the term "fixed rate share" 40 the expression "section CF 3", and substituting the expression "sections CF 3 and **GD 13**".

(11) Section OB 1 is further amended by inserting, in paragraph (a) of the definition of the term "life insurer", after the term " 'claim' ", the term " 'dividend',". 45

(12) Section OB 1 is further amended by repealing the definition of the term "mineral", and substituting the following definition:

" 'Mineral', or 'minerals', includes all minerals, metals, coal, oil, kauri gum, clay, stone, gravel, sand, and precious stones:".

(13) Section OB 1 is further amended by inserting, after the definition of the term "New Zealand film", the following definition:

" 'New Zealand group debt percentage' means, in respect of a taxpayer and an income year, the percentage calculated under section FG 4:".

(14) Section OB 1 is further amended by repealing the definition of the term "non-resident investment company".

(15) Section OB 1 is further amended by repealing the definition of the term "non-resident portfolio investor".

(16) Section OB 1 is further amended by repealing paragraph (b) of the definition of the term "paid".

(17) Section OB 1 is further amended by omitting from paragraph (g) of the definition of the term "residual income tax" the expression "section LE 1", and substituting the expression "**Part LE**".

(18) Section OB 1 is further amended by repealing the definitions of the terms "primary metal", "second specified period", and "specified industrial undertaking".

(19) Section OB 1 is further amended by omitting from paragraph (b) of the definition of the term "settlement" the expression "section HH 1", and substituting the expression "**sections FG 2** and HH 1".

(20) Section OB 1 is further amended by repealing the definition of the term "supplementary dividend", and substituting the following definition:

" 'Supplementary dividend', in **Part LE** in respect of any company and any person deriving a dividend (referred to in this definition as the first dividend) from the company, means a dividend—

"(a) Paid by the company in the same income year as the first dividend; and

"(b) Paid with respect to the first dividend; and

"(c) Also derived by that person; and

"(d) Which is equal in amount to the tax credit calculated, with respect to the first dividend, under **section LE 2 (2)**:".

(21) Section OB 1 is further amended by inserting, after the definition of the term "supplementary dividend", the following definition:

" 'Supply' is defined in **section GD 13 (13)** for the purposes of that section:". 5

(22) Section OB 1 is further amended by repealing paragraph (b) of the definition of the term "taxable income".

(23) Section OB 1 is further amended by inserting, after the definition of the term "work related vehicle", the following definition: 10

" 'Worldwide group debt percentage' means, in respect of a taxpayer and an income year, the percentage calculated under **section FG 5**:".

(24) **Subsections (5), (7) (b) and (c), (8), (11), (15), (17), and (20)** apply with respect to dividends paid on or after the day on which this Act 15 receives the Royal assent.

24. Meaning of "non-resident investment company"— The principal Act is amended by repealing section OB 5.

25. Meaning of "income tax"—Section OB 6 (1) of the principal Act is amended— 20

(a) By omitting from paragraph (a) the expression "paragraphs (b) to (k)", and substituting the expression "paragraphs (b) to (i)":

(b) By repealing paragraphs (h), (j), and (k).

26. Further definitions of associated persons— 25
(1) Section OD 8 (3) of the principal Act is amended—

(a) By omitting the expression "Part LF" where it first occurs, and substituting the expression "**Parts FG** and LF":

(b) By omitting the expression "EZ 9, HK 11,", and substituting the expression "EZ 9, **GD 13**, and HK 11": 30

(c) By omitting the expression "and LE 1" where it first occurs:

(d) By omitting from the proviso to paragraph (a) the expression "Part LF and sections CG 8, HK 11,", and substituting the expression "**Parts FG** and LF and 35 sections CG 8, **GD 13**, and HK 11":

(e) By omitting from the proviso to paragraph (a) the expression "and LE 1".

(2) **Paragraphs (c) and (e) of subsection (1)** apply with respect to dividends paid on or after the day on which this Act receives 40 the Royal assent.

27. References to income years in particular provisions—(1) Section OF 2 (2)(i) of the principal Act is amended by adding the following subparagraph:

"(iii) **Part FG**:".

5 (2) Section OF 2 (2)(m) is amended—

(a) By inserting, after subparagraph (ii), the following subparagraph:

"(iia) **Part LE**:":

(b) By repealing subparagraph (iv).

10 (3) **Subsection (2) (a)** of this section applies with respect to dividends paid on or after the day on which this Act receives the Royal assent.

28. Schedule 1 amended—(1) Part A of Schedule 1 to the principal Act is amended by repealing clauses 3 and 6.

15 (2) Part A of Schedule 1 is further amended by repealing clause 5, and substituting the following clause:

"5. **Companies**—On all income not included within any of the provisions of clauses 1 to 4, the basic rate of income tax on the taxable income derived by a company shall be 33 cents for

20 every $1 of that taxable income."

PART II

TAX ADMINISTRATION

29. Part to be read with Tax Administration Act 1994—This Part of this Act shall be read together with and deemed

25 part of the Tax Administration Act 1994* (in this Part referred to as the principal Act).

30. Determinations in relation to apportionment of interest costs—(1) The principal Act is amended by inserting, after section 90, the following section—

30 "90A. (1) For the purposes of **Part FG** of the Income Tax Act 1994, the Commissioner may determine the extent (if any) to which a financial arrangement provides funds to the issuer.

"(2) Any determination made under **subsection (1)** shall be binding on persons for the purposes of **Part FG** of the Income

35 Tax Act 1994.

"(3) Any taxpayer may apply to the Commissioner to exercise the Commissioner's discretion to make a determination under **subsection (1)**, and every such application shall be made in accordance with such procedure as may be

40 prescribed by regulations made under this Act; or, if no such

*1994, No. 166
Amendment: 1995, No. 24

regulations have been made or the regulations do not provide for the eventuality that occurs, in accordance with such procedure as may be prescribed by the Commissioner.

"(4) Where the taxpayer is dissatisfied with the determination, the taxpayer may object to the determination by delivering or posting to the Commissioner, within one month after the date on which notice of the determination has been published by the Commissioner, a written notice of objection stating shortly the grounds of that taxpayer's objection.

"(5) Except where it is otherwise expressly provided, Part VIII, except section 125, shall in relation to any objection to a determination under this section, apply in the same manner and to the same extent as if the objection were an objection made under section 126 (1) or, in the case of a late objection, section 126 (2).

"(6) Where the Commissioner is satisfied that a determination made under **subsection (1)** should be varied or rescinded, or restricted or extended in scope, the Commissioner may make a fresh determination which shall be effective to vary, rescind, restrict, or extend the determination first mentioned in this subsection:

"Provided that no such fresh determination shall be required to be applied by any person until the first income year which commences after the notification of, or publication of, that fresh determination.

"(7) All determinations made by the Commissioner under **subsection (1)** shall be published in the *Gazette* within 30 days of the making of the determination, in such form as may be specified by regulations made under this Act.

"(8) For the purposes of this section, a determination shall be deemed to be made when it is signed by the Commissioner.

"(9) Where a person applies a determination, the Commissioner shall assess the person in accordance with the determination made under **subsection (1)** except where—

"(a) Since the date of the determination the legislation on which the determination was based has been repealed or amended to the detriment of the person relying on the determination; or

"(b) There was a material misrepresentation or omission in the application for the determination, whether intentional or not."

(2) This section applies with respect to the tax on income derived in the 1996–97 income year and subsequent years.

31. Commissioner to make private rulings on request—(1) Section 91E of the principal Act is amended by inserting, after subsection (4), the following subsection:

"(4A) Subsection (4) (a) shall not apply where the application for the ruling relates to how section FB 2 or **section GD 13** of the Income Tax Act 1994 apply to a particular person and a particular arrangement."

(2) This section applies with respect to the tax on income derived in the 1996–97 income year and subsequent years.

32. Commissioner to make assessments, determinations of loss, and other determinations—(1) Section 92 of the principal Act is amended—

(a) By omitting from subsection (2) (a) the words "and section GC 1 of the Income Tax Act 1994":

(b) By repealing subsection (3) (d):

(c) By omitting from subsection (5) the words "and section GC 1 of the Income Tax Act 1994".

(2) This section applies with respect to the tax on income derived in the 1996–97 income year and subsequent years.

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