



NEW ZEALAND

INTERNATIONAL TAX RULES REVIEW

A Government Discussion Document released in December 2006 proposes comprehensive reform of the rules governing the taxation of offshore non-portfolio investments (holdings of greater than 10% in overseas companies). The key proposal is the introduction of an active income exemption for controlled foreign companies (CFCs). However, a number of other issues are considered in the Discussion Document, including:

- exempting dividends from CFCs (both active and passive income) from dividend withholding payment;
- removing the grey-list exemption in relation to CFCs;
- considering whether the active/passive distinction should apply also to non portfolio investments that are not CFCs (i.e., investments in the range of 10% to 40%/50%) and to foreign branches;
- amending the thin capitalisation/interest allocation rules so that they apply to both foreign owned companies and locally owned companies with offshore investments;

- lowering the thin capitalisation “safe harbour” ratio and excluding items such as goodwill and investments in CFCs from the definition of assets for thin capitalisation purposes;
- abolishing the conduit tax relief regime; and
- reducing the non resident withholding tax rates applicable to dividends between non-portfolio group companies (through bilateral double tax agreement negotiations) but probably maintaining the rates negotiated for interest and royalties at 10%.

The Government expects to be in a position to make a decision on the form the changes will take by mid-2007. Following further consultation, the changes are expected to be included in a bill to be introduced into the Parliament in late 2007 or early 2008.

TAXATION OF INVESTMENT INCOME

Legislation enacted in December 2006 comprehensively reforms the rules governing the taxation of:

- New Zealand managed funds; and
- offshore portfolio equity investments.

From 1 April 2007, a pooled collective investment vehicle (i.e., a managed fund or super fund) that qualifies as a “portfolio investment entity” (PIE) will be able to elect into a new set of tax rules (the PIE rules). The PIE rules will apply from 1 October 2007.

To be eligible to elect to become a PIE, the entity must be a New Zealand resident company (including unit trusts), superannuation fund or group investment fund that meets specific criteria in relation to investor size and investment type.

The key tax changes under the PIE rules are:

- Taxable income is allocated to investors and tax paid by the PIE on behalf of the investors, at their marginal tax rates, at a maximum of 33%.
- A distribution from a PIE is “excluded income” and therefore not taxable to the investor.
- Any gains/losses that the PIE makes on the sale of shares in New Zealand companies and certain Australian resident companies listed on an approved index of the Australian stock exchange are non taxable/non deductible.

The changes to the taxation of offshore portfolio equity investments impact investors with a shareholding or interest of less than 10% in a foreign company, unit trust, certain foreign superannuation schemes and all life insurance policies.

The offshore portfolio investment rules apply from 1 April 2007 for most investors. However, a company, group investment fund or superannuation fund that intends to be a PIE can elect to delay the application of the new offshore tax rules until 1 October 2007.

The key changes to the taxation of offshore portfolio equity investments are:

- The “grey list” will no longer apply to investments that fall within the new regime.
- From the start of the 2007/2008 income year individual and family trust investors will be taxable on the lower of their actual return (all gains and dividends) from their investments or 5% (the so called “fair dividend rate” or “FDR”) of the opening market value of the investments each year.
- A deemed realisation occurred on 31 March 2007 for revenue account investors holding shares in grey list countries that become subject to the new regime. This crystallises tax liabilities (payment of the tax is able to be spread over three years) for these investors.
- Shares in certain Australian resident listed companies are excluded from the new rules.
- Temporary exclusions apply to holdings in Guinness Peat Group and the New Zealand Investment Trust.
- If an individual’s non-excluded investments have an aggregate cost of NZD\$50,000 or less, the entire portfolio is excluded from the new rules and is taxed under the current rules.
- All investments excluded from the new rules (either permanently or temporarily) will continue to be taxed as they are currently.

LIFE INSURANCE TAX REFORM

The Government is carrying out a comprehensive review of the taxation of life insurance. Officials released papers in September 2006 and February 2007 outlining the scope of the review and seeking industry feedback on the direction of the reform.

The review suggests a new model for taxing life insurance products that would tax life insurers on their net income reported in accordance with International Financial Reporting Standards (IFRS) and incorporate aspects of the PIE rules.

The reforms are expected to be included in a bill to be introduced into the Parliament in late 2007.

BUSINESS TAX REVIEW

The Government’s Business Tax Review Discussion Document released in July 2006 sets out a number of proposals aimed at increasing productivity and boosting New Zealand’s international competitiveness.

The proposals most likely to be implemented are:

- A reduction in the corporate tax rate from 33% to 30%; and
- The introduction of targeted tax credits for research and development, export market development and skills enhancement expenditure.

The outcome of the Business Tax Review will be announced in the Government’s May 2007 Budget. Any changes are likely to come into effect on 1 April 2008.

TRANS-TASMAN DEVELOPMENTS

The Government has agreed to start the process of negotiating a revised double tax treaty with Australia. The revised treaty is likely to include lower withholding tax rates on dividends.

The New Zealand and Australian Government will also:

- Investigate the feasibility of trans-Tasman private retirement savings portability;
- Continue to work towards a Closer Economic Relations Investment Protocol; and
- Continue to facilitate the coordination of business laws.

KIWISAVER

The KiwiSaver Act 2006 establishes a generic voluntary work-based savings scheme for employees (both part and full time) who are either New Zealand citizens or permanent residents. KiwiSaver will commence on 1 July 2007.

Participating employees will contribute either 4% or 8% of their gross salary or wages to the KiwiSaver scheme.

Employers will not be required to make employer contributions to the scheme. However, any employer contributions to KiwiSaver (or other qualifying registered superannuation schemes) are exempt from specified superannuation contribution withholding tax up to the lesser of an amount equal to the employee's contribution or 4% of the employee's salary or wages.

Contributions will be locked in until the member becomes entitled to New Zealand Superannuation (currently at age 65) although exceptions will be made in certain circumstances.

All KiwiSaver schemes can elect to be a PIE and take advantage of the new tax rules for collective investment vehicles.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

It is mandatory for New Zealand entities to adopt IFRS for financial statements covering periods beginning on or after 1 January 2007. Early adoption of the standards has been allowed since 1 January 2005. Entities which have adopted IFRS or are preparing to do so need to consider the tax implications of changes that arise under IFRS. These will differ from entity to entity. Tax changes related to the adoption of IFRS will be included in the May 2007 tax bill with the most significant changes likely to be in relation to financial arrangements.

EXEMPTIONS FOR NEW MIGRANTS

In April 2006 the Government introduced two new initiatives designed to remove some of the existing tax disincentives for individuals to migrate to New Zealand:

- A temporary (four year) exemption from income tax for certain overseas income including dividends and interest derived by new migrants or New Zealanders who return to New Zealand after an absence of at least 10 years. The exemption applies to people becoming resident in New Zealand on or after 1 April 2006; and
- An extension of an existing exemption from income tax for interests in foreign employment related superannuation schemes. The exemption applies to interests in such schemes held by returning residents as well as new migrants who become New Zealand tax resident on or after 1 April 2006. The exemption is permanent for interests acquired before and within the first five years of New Zealand residence.

PARTNERSHIPS

A Government Discussion Document released in June 2006 outlines proposals to codify the tax rules relating to general partnerships and introduce new rules applying to limited partnerships. The focus of the proposals is to clarify and codify existing law and practice while introducing a limited partnership regime to replace the current special partnership structure.

A Bill introducing the new rules is expected to be introduced into the Parliament in 2007.

