Regulatory Impact Statement

Tax concessions for certain non-resident investment companies

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

The question in this Statement is whether residual tax concessions for certain non-resident investment companies in the Income Tax Act 2007 are still appropriate in the modern tax policy environment and, if not, whether the concessions should be repealed.

In preparing this Statement, we have consulted with the two New Zealand companies affected by the proposal. The companies did not raise any technical or implementation issues that required addressing in developing this proposal. The companies are aware that this proposal may be included in a tax bill to be introduced this year and may make a submission on the proposal at the select committee stage of the relevant tax bill. We have also consulted with the Treasury, which agrees with our analysis.

The proposal provides for a more level playing field for non-resident investors and would therefore improve (marginally) market competition.

No significant gaps, assumptions, dependencies, constraints, caveats or uncertainties in the proposal have been identified. The proposal also has no significant administrative or compliance implications and does not impair private property rights, provide disincentives to innovate and invest or override common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. The Income Tax Act 2007 provides residual tax concessions for certain non-resident companies investing in projects specified under four Orders in Council. The main concession applies to interest derived by these non-resident companies from specified projects.

2. The income tax on interest derived by a non-resident from a specified project is limited to the lower of the New Zealand company tax rate and the tax rate imposed in the non-resident company's home country. This is done by providing a tax credit for the amount (if any) by which the New Zealand company tax exceeds the amount of home tax. A similar concession applies for dividends derived by a non-resident from specified projects. The interest paid to the non-resident investment company is also exempt from non-resident withholding tax.

3. The tax concessions for non-resident investment companies were generally repealed in 1995. Such concessions were considered inconsistent with a broad-base, low rate tax framework and largely redundant in light of international tax reforms at that time, such as the approved issuer levy (AIL) regime, the extension of the foreign income tax credit (FITC) regime to direct investors, and the removal of the higher tax rate on New Zealand branches of non-resident companies.

4. However, the concessionary rules were grandparented to cater for the four Orders in Council then in force that applied to projects developed in the early 1970s. The four Orders in Council are:

- Income Tax (Non-resident Investment Companies) Order 1970;
- Income Tax (Non-resident Investment Companies) Order 1972;
- Income Tax (Non-resident Investment Companies) Order (No 2) 1972; and
- Income Tax (Non-resident Investment Companies) Order (No 3) 1974.

5. One of these Orders in Council relates to the Tiwai Point aluminium smelter. Two of the Orders relate to one company in the forestry sector. The remaining Order is spent because the company it relates to no longer exists.

6. The question in this Statement is whether residual tax concessions in the Income Tax Act 2007 for certain non-resident investment companies are still appropriate in the modern tax policy environment and, if not, whether the concessions should be repealed.

OBJECTIVES

7. The main objective is to review the residual tax concessions and determine if they are consistent with a broad-base, low rate tax policy framework and ensure horizontal equity between non-resident investors in New Zealand.

REGULATORY IMPACT ANALYSIS

8. The concessions were originally provided in a period when it was more common to incentivise particular investments through the tax system. New Zealand's tax system has moved away from this by progressively repealing specific tax concessions under the broad-

base, low rate tax policy framework. Continuing to provide the tax concessions for certain non-resident investment companies is therefore inconsistent with the current tax policy framework.

9. Also, the tax concessions were originally designed to encourage non-residents to establish development projects in New Zealand which required funding from outside New Zealand. The specified projects started in the early 1970s have been long-established and therefore the concessions could be regarded as having outlived their original purpose. Moreover, retaining the tax concessions also poses a revenue risk since they can allow certain non-resident investors to minimise the New Zealand tax on the income from these projects.

10. On the basis that the residual tax concessions for certain non-resident investment companies are not appropriate in the modern tax policy environment, the options that we have identified are to either repeal the residual tax concessions or phase them out. The preferred option is to repeal the residual tax concessions since the concessions already have grandparented status.

11. The preferred option of repealing the tax concessions would result in a small estimated increase of $1 to $3 million in tax revenues. The impact of this option is limited to a very small number of New Zealand companies that will no longer benefit from these tax concessions. This approach is consistent with the broad-base, low rate tax framework and results in horizontal equity between non-resident investors in New Zealand.

12. There are no significant administrative or compliance implications from this option. No social, environmental or cultural costs are expected to arise under this option.

CONSULTATION

13. Inland Revenue has consulted with the two New Zealand resident companies affected by the proposal. The companies did not raise any technical or implementation issues that required addressing in developing this proposal. The companies are aware that this proposal may be included in a tax bill to be introduced this year and may make a submission on the proposal at the select committee stage of the relevant tax bill. Inland Revenue has also consulted with the Treasury, which agrees with the analysis and recommended option.

CONCLUSIONS AND RECOMMENDATIONS

14. The recommended option is to repeal residual tax concessions for certain non-resident investment companies. This would be done by repealing the grandparented concessions in the Income Tax Act 2007 and revoking the relevant Orders in Council.

IMPLEMENTATION

15. The necessary legislative change would be included in the tax bill scheduled to be introduced in July 2012 and apply from the 2013–14 income year.

16. New Zealand resident companies affected by the amendment would have to deduct and return non-resident withholding tax (NRWT) from interest payments relating to specified projects made to non-resident investment companies on a continuing basis.

17. There are no administrative issues arising from the amendment.

MONITORING, EVALUATION AND REVIEW

18. Given the limited effect of the proposal and the fact that its effect is to align the tax law with current tax policy framework, there are no plans to monitor, evaluate and review the effect of these amendments. If any specific concerns are raised, officials will determine whether there are substantive grounds for review under the Generic Tax Policy Process. Also, the Income Tax Act 2007 is subject to regular review by officials.