



3 November 2009

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By email: john.marney@ird.govt.nz

Dear John

Proposed amendments to the supplementary dividend and withholding tax rules for foreign direct investors

Provisions relating to repeal of FITC for non-portfolio dividends

1. The Society's Taxation Committee (the Committee) appreciates the opportunity to comment on the draft amending legislation which is to be included by way of Supplementary Order Paper in the Taxation (Consequential Rate Alignment and Remedial Matters) Bill. We have no comments on the draft legislation relating to the repeal of the tax credit for supplementary dividends (FITC)¹ as it relates to non-portfolio dividends.
2. A consequence of the FITC related amendments is that the supplementary dividend holding company mechanism will no longer be available from 1 April 2011, even for groups of companies continuing to pay FITC relieved dividends to non-resident portfolio investors. The commentary accompanying the draft legislation suggests at paragraph 14 that this reflects the fact that "holding company structures are most likely to be used by non-portfolio investors". The Committee is not aware of specific situations in which repeal of the supplementary dividend holding company mechanism would result in a FITC (in a portfolio investor context) not being able to be utilised. Were such a situation to arise however, the consequences would be unwelcome, as the affected portfolio investors would bear tax on underlying earnings at the full 30% rate, as well as NRWT at 15% on the amount distributed. If such a situation were to arise in the future, serious consideration should be given to amendments addressing these adverse consequences.

Recent Double Tax Agreement (DTA) changes that should be clarified

3. The Interest Article in the revised DTAs with Australia and the United States raises a separate issue which could be clarified at the same time as other amendments relating to the revised DTAs. In order for interest to qualify under those revised DTAs for 0% source country tax when paid to an unrelated financial institution, approved issuer levy

¹ For convenience, reference throughout this letter to the regime, using the Income Tax Act 2004 terminology, is "FITC".

(AIL) must have been paid on the interest, unless “the payer of the interest is not eligible to elect to pay the [AIL]”.

4. It is unclear how this provision applies to interest paid to a financial institution that carries on business in New Zealand through a fixed establishment in New Zealand is unclear. Such interest is not subject to non-resident withholding tax (NRWT)² even if the interest is not derived through the New Zealand fixed establishment.
5. For example, a financial institution (AusCo) is tax resident in Australia, and has a fixed establishment in New Zealand, but derives New Zealand-sourced interest (eg interest paid by a New Zealand tax resident borrower³) through its Australian head office. The interest is taxed on an assessment basis - it must be included in AusCo’s New Zealand tax return. New Zealand tax is payable at the corporate tax rate on the net New Zealand sourced interest income (taking into account available deductions) subject to DTA relief.
6. Under the current tax treatment, it would be pointless to pay AIL in respect of such interest because, prior to the revised DTAs coming into force, the only benefit in paying AIL is eliminating NRWT otherwise payable under domestic law. In the scenario outlined above, no NRWT would be payable.
7. Under the revised DTAs, the fact the interest is not subject to NRWT under domestic law does not mean that “the payer of the interest is not eligible to elect to pay the [AIL]”. AIL is a voluntary regime; all that is required for a person to be eligible to pay AIL is that the person be registered as an “approved issuer” under section 32M(2) of the Tax Administration Act 1994 (TAA). Consistent with this reading of the text of the relevant DTA provisions and the legislative requirements for paying AIL, Inland Revenue’s view seems to be that AIL must be paid in order to access the 0% source country tax rate under the DTA, even if the interest would not have been subject to NRWT under domestic law but would have been taxed on an assessment basis.

Legislative provisions requiring amendment

8. Assuming this is the intended outcome, some legislative references which describe AIL as being for the “purposes of the NRWT rules” should be updated to reflect the fact that the consequences of AIL being paid are no longer confined to the NRWT rules. These references are:
 - (a) Sections 32M(1) and (5) of the TAA, which describe approved issuer status as being “for the purposes of the NRWT rules”.
 - (b) Section 86I of the Stamp and Cheque Duties Act 1971 (S&CDA), which refers to a payment of interest being treated as being paid by an approved issuer in respect of a registered security “[f]or the purposes of the NRWT rules of the Income Tax Act 2007 and section 86J of this Act, and notwithstanding any provision of the NRWT rules of the Income Tax Act 2007”.

² Section RF 2(1)(d) of the Income Tax Act 2007 (Income Tax Act)

³ Interest paid in respect of money lent to a New Zealand resident will have a New Zealand source, unless the money is used by the person for the purposes of a business they carry on outside New Zealand through a fixed establishment outside New Zealand (section YD 4(11) of the Income Tax Act)

- (c) Section 86L(2) of the S&CDA, which states that when the Commissioner refunds excess AIL, the relevant payment of interest shall be deemed not to have been paid in respect of a registered security “for the purposes of the NRWT rules of the Income Tax Act 2007”.
9. We also suggest that an explanation of the application of AIL in the DTA context be included in a *Tax Information Bulletin*. This could be by way of update to the statement QB 09/05: “Residential Investment Property or Properties in Australia Owned by New Zealand Resident – NRWT Treatment of Interest Paid to Australian Financial Institution”, *Tax Information Bulletin*, Volume 21, No. 6 (August 2009).

The committee trusts these comments are helpful. If you require further assistance please do not hesitate to contact Diana Brown, the committee secretary, by phone (04) 463-2967 or email diana.brown@lawsociety.org.nz.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Casey Plunket', written in a cursive style.

Casey Plunket
Convener, Taxation Committee