

AIL, NRWT and the bond market

An officials' issues paper

September 2009

Prepared by the Policy Advice Division of Inland Revenue and the Treasury

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Chapter 1

INTRODUCTION

- 1.1 Like many countries, New Zealand imposes non-resident withholding tax (NRWT) on dividends, interest and royalty payments to non-residents. NRWT applies at a different rate depending on whether the payment is a dividend, interest or royalty.
- 1.2 As shown in table 1, NRWT rates are generally reduced if New Zealand has a double tax agreement with the non-resident's country. There are also arrangements under domestic law that reduce the impact of NRWT in certain circumstances.

Table 1:
NRWT rates in domestic law and double tax agreements

	Dividends	Interest	Royalties
Domestic law rate	30% if unimputed; 15% if imputed.	15% generally, but: 0% if the non-resident is not associated with the interest payer and the 2% approved issuer levy is paid.	15%
Typical NZ DTA rate (some treaties include higher rates).	15%	10%	10%
Protocol to NZ-US DTA (not yet in force).	15% generally, but: 5% for dividends if a company investor has a 10% or higher stake in the company paying the dividend; and 0% for dividends if a company investor has an 80% or higher stake.	10% generally, but: 0% for interest received by a lending or finance business unrelated to the interest payer, provided (in the case of New Zealand-sourced interest), the 2% approved issuer levy is paid.	5%

- 1.3 Along with company tax, NRWT helps to ensure that non-residents are taxed on the income they earn from New Zealand. It raises revenue by taxing dividend, interest and royalty payments made by New Zealanders to foreign investors. It provides a backstop to the company tax base by limiting the extent to which these payments can be used to shift New Zealand income offshore.

- 1.4 In some countries, NRWT can be used to reduce taxes in the non-resident's home country on the dividend, interest or royalty payment. Notwithstanding this, NRWT can still add to the cost of funds for New Zealand businesses in certain circumstances. For example, lenders will often contractually require the borrower to bear the cost of the NRWT in the loan agreement.
- 1.5 New Zealand has some existing measures, such as the approved issuer levy (for interest paid to an unrelated party) and supplementary dividend tax credits (for imputed dividends), which help to reduce the impact of NRWT on inbound financing and investment, without undermining the role that it plays in sustaining company tax revenues.
- 1.6 Concerns have been raised that the current approved issuer levy (AIL) and NRWT rules may be one factor hindering the development of New Zealand's corporate bond market. This paper examines the question of whether the approved issuer levy should apply at a zero rate (rather than the usual rate of 2 percent) on interest paid on corporate bonds which meet certain criteria.
- 1.7 Because of the fiscal costs and risks of removing NRWT and AIL on interest, it would be useful to receive submissions on the extent to which AIL affects bond issuance and the way that businesses raise funds, relative to other factors.
- 1.8 To manage the fiscal risks posed by related party and closely held debt we suggest in this paper that certain criteria would be used to limit the zero rate of AIL to widely held debt. Submissions are sought on the suggested changes outlined below.

Summary of suggested changes

AIL would apply at a rate of zero for interest paid on qualifying bonds.

A "qualifying bond" would be a debt security that belonged to a group of identical debt securities that satisfied the widely held test or the stock exchange test.

The widely held test would require:

- the debt securities to be held by at least 100 investors (who are not associated or who could not reasonably be expected by the issuer to be associated); and
- no person (or group of persons that the issuer could reasonably expect to be associated with each other) holds more than 10 percent of the debt securities (disregarding an underwriter for the first year).

The issuer would be required to apply the test annually to check that the thresholds were still satisfied.

The stock exchange test would require the debt securities to be listed on a recognised stock exchange.

Exclusions

A debt security would not be a qualifying bond if:

- it has been issued through a private placement that is limited to a select group of investors; or
- it has not been openly advertised to the target market during the book-build process; or
- it is an asset-backed security – that is, any security where the interest payments are financed by cashflows from a pool of financial assets.

How to make a submission

1.9 Submissions should be made by 30 October 2009 and be addressed to:

NRWT and the bond market
C/- Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue Department
PO Box 2198
Wellington 6140

Or e-mail: policy.webmaster@ird.govt.nz with “AIL, NRWT and the bond market” in the subject line.

1.10 Submissions should include a brief summary of their major points and recommendations. They should also indicate whether it would be acceptable for Inland Revenue and Treasury officials to contact those making the submission to discuss the points raised, if required.

1.11 Submissions may be the source of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making a submission who feel there is any part of it that should properly be withheld under the Act should indicate this clearly.

Chapter 2

ZERO-RATING AIL ON BONDS

Non-resident withholding tax and the approved issuer levy

- 2.1 New Zealand subjects interest payments to non-residents that arise within New Zealand to non-resident withholding tax (NRWT) at rates of 10¹ or 15² percent.
- 2.2 If the non-resident lender is not associated (that is, unrelated) with the New Zealand borrower, the New Zealand borrower can elect to pay a 2 percent approved issuer levy (AIL). In these cases NRWT on the interest payment is reduced to zero.
- 2.3 However, under the NRWT rules, a higher tax is applied to related-party lending to reduce incentives for companies to use tax-deductible interest payments to shift New Zealand profits into related offshore companies and out of the New Zealand tax base.
- 2.4 In some countries, NRWT can be used to reduce home taxes on interest income received from New Zealand. However, it is common practice for the tax costs to be added to the standard interest rate. Often lenders will contractually require the borrower to bear the cost of the NRWT in the loan agreement. In these cases, the New Zealand borrower would be better off paying AIL at 2 percent, rather than grossing up the interest payment by 10 or 15 percent for NRWT.

Status quo and problem

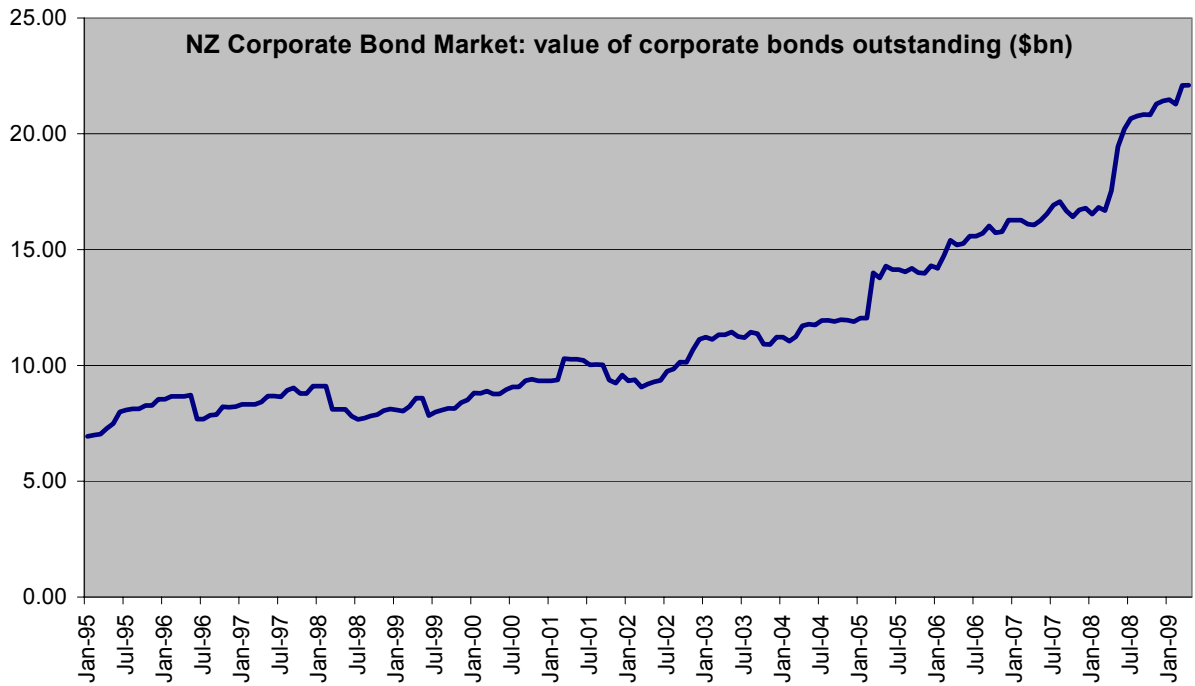
- 2.5 New Zealand's corporate bond market is a minor part of our financial system, but has experienced strong recent growth. Since 2005 the total value of corporate bonds on issue has increased from \$12 billion dollars to \$23 billion dollars.³ As at December 2008 the domestic bond market was the source of about 4 percent of all debt for non-financial businesses. The bulk of business debt was raised through domestic financial institutions (61 percent) and from offshore (26 percent from significant stakeholders and 9 percent from others).⁴ The following graph illustrates this growth.

¹ If New Zealand has a tax treaty with the non-resident's country.

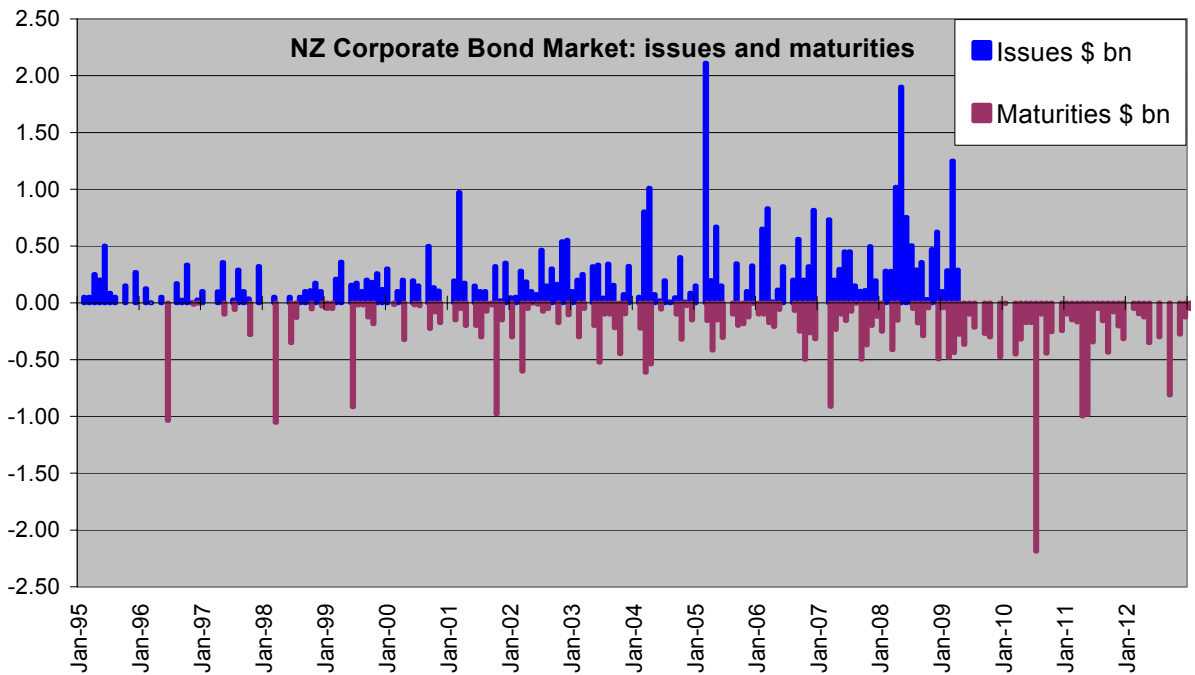
² If a non-treaty country or Japan.

³ Reserve Bank of New Zealand, *Financial Stability Report*, May 2009.

⁴ Reserve Bank of New Zealand, *Financial Stability Report*, May 2009.



Source: RBNZ, *Financial Stability Report*, May 2009



Source: RBNZ, *Financial Stability Report*, May 2009

2.6 A well-functioning bond market has a number of important signalling and support roles which affect the performance of the wider financial system. For example:

- Bond markets provide an observable benchmark for pricing derivatives and equities.
- Bond markets make financial investment more attractive by providing a broader range of options (and risk/return profiles) for savers. This may result in more savings becoming available to fund investment.
- Bonds can reduce the effective cost of funds and provide longer-term financing options for firms (especially those with long-term growth potential such as infrastructure firms).
- A strong bond market can make the economy less vulnerable to a banking crisis, through diversification of lending instruments.

2.7 Concerns have been raised that the current AIL/NRWT rules may be one factor hindering the further development of New Zealand's corporate bond market. This is because AIL/NRWT increases the cost of issuing bonds to non-residents. For example, a non-resident investor who requires a 10 percent return to buy bonds from a New Zealand company would require the company to pay an interest rate of 10.2 percent to ensure that the investor gets the required return after AIL is deducted.

2.8 The impact of AIL on the domestic bond market could be exacerbated by the fact that it is possible for companies to establish foreign branches and borrow through these branches without paying AIL or (as an alternative) NRWT. On the other hand, interest payments on bonds issued in the domestic market are subject to either AIL or NRWT. This means that issuing bonds on the domestic market may be discouraged relative to issuing bonds through an offshore branch or borrowing directly through domestic banks.

Zero-rating AIL on bonds

2.9 The impediment could be removed by having AIL apply at a rate of zero (rather than the usual rate of 2 percent) on interest paid on corporate bonds, subject to certain criteria discussed below.

2.10 A zero rate of AIL on bonds would make it marginally cheaper to issue bonds to non-residents. This could lead to further growth in issuance and a better-functioning New Zealand bond market as it would reduce the cost of foreign funds and increase the pool of potential investors.

- 2.11 It is difficult to gauge the extent to which a zero rate on AIL would lead to increased bond issuance. Many factors influence bond issuing decisions besides interest costs. These include a desire to secure larger or longer-term finance, maintain a good credit rating, or gaining access to a larger pool or different set of investors.
- 2.12 Because of the fiscal costs and risks of removing NRWT and AIL on interest, it would be useful to receive submissions on the extent to which AIL affects bond issuance and the way that businesses raise funds, relative to other factors.

Maintaining the corporate tax base

- 2.13 As well as raising revenue directly, AIL/NRWT plays a critical role in supporting the domestic tax base. It does this in two ways. In related party debt transactions, it reduces the incentive for corporate groups to shift income offshore by paying interest to a related company in another country. In closely held debt arrangements, it can provide an incentive to maintain banking activity in New Zealand. If either tax base were compromised, New Zealand would lose significant amounts of revenue. The remainder of this paper will consider whether it is possible to develop rules and criteria that would allow AIL and NRWT to be relieved on widely held bonds, while ensuring that related party transactions and closely held debt arrangements are still subject to the existing rates of AIL or NRWT.

Related party debt

- 2.14 The risk from related party debt transactions could be managed through the existing AIL/NRWT settings. These settings ensure that NRWT only applies at a zero rate if the following conditions are satisfied:
- the interest payer (borrower) must register as an approved issuer and pay the approved issuer levy (approved issuer status can be revoked if taxpayers fail to meet their tax obligations);
 - the interest must be paid to a non-resident who is not associated with the approved issuer; and
 - the interest payment cannot be jointly derived with a New Zealand resident.
- 2.15 A zero rate of AIL for qualifying bonds would not alter these requirements. This means that NRWT would continue to apply at 10 percent or 15 percent for any interest paid to a non-resident who was associated with the interest payer, regardless of whether the interest was paid on qualifying bonds. Likewise, a 2 percent rate of AIL would continue to apply to unrelated debt that did not meet the requirements of a qualifying bond issue.

Closely held debt

- 2.16 If the government were to introduce a zero rate of AIL on bonds, it would have to be confident that it could not be used to remove NRWT and AIL on interest paid on closely held debt. Otherwise, there could be an increased incentive for loans to be made directly from offshore (for example, by a foreign bank). In such cases, the margin earned on the loan would no longer be subject to New Zealand tax. This could pose a significant fiscal risk to New Zealand because of the importance of the banking sector to our corporate tax base.

Some key differences between closely held debt and bonds

Closely held debt	Bonds
Not typically bought and sold (unless securitised).	Usually bought and sold on financial markets.
Typically a single lender or a small number of syndicated banks.	Can be widely held by a large number of retail investors or by a smaller (or larger) number of professional investors.
Range of different loan sizes and maturities.	Typically used for larger, multi-million dollar deals with longer-term debt available in sophisticated markets.
Not generally registered on an exchange.	Retail bonds more often registered on exchanges in regulated markets such as NYSE or LSE.

- 2.17 It may be possible to manage this risk by developing some specific criteria that could be used to exclude closely held debt. Under this approach, AIL would apply at a zero rate on interest paid on a qualifying bond that satisfied the criteria. AIL would continue to apply at the usual rate of 2 percent on debt which did not qualify.
- 2.18 Suggested criteria for a zero rate of AIL on bonds are discussed below.

Australia's public offer test

- 2.19 Australia's "public offer test" exemption provides some examples of the types of criteria that could be applied.
- 2.20 Australia provides an exemption from withholding tax on interest paid on bonds (or syndicated loans) issued by an Australian company (or an intermediary that issues the bonds on an Australian company's behalf) which satisfies one of the four public offer tests. The test is satisfied if the bonds are offered to 10 financiers (who are unrelated to the Australian company and each other) or 100 other potential investors, or are listed on a stock exchange or are quoted in a published source that is monitored by investors. However, if the bonds are issued to an associated person, the interest payments remain subject to withholding tax. (See appendix I for a more detailed description of Australia's public offer tests.)

- 2.21 Australia’s public offer test exemption can apply to syndicated loans⁵ and closely held bonds. New Zealand would require tighter criteria, given our objective for AIL to continue to apply at a rate of 2 percent on closely held debt.
- 2.22 We suggest that a zero rate of AIL would typically apply if either of two tests were satisfied:
- the widely held test; or
 - the stock exchange test.

The widely held test

- 2.23 The widely held test would require:
- the bonds to be held by at least 100 investors (who are not associated or who could not reasonably be expected by the issuer to be associated); and
 - no person (or group of persons that the issuer could reasonably expect to be associated with each other) holds more than 10 percent of the bonds.
- 2.24 The issuer would be required to apply the test annually to check that the thresholds were still satisfied.
- 2.25 One drawback with the 10 percent limit is that it could deny the zero rate if an underwriter is required to purchase a significant proportion of the remaining bonds that it had failed to sell during the initial offering. For this reason it would make sense to disregard bonds initially held by an underwriter for the purposes of the maximum number of bonds test so long as the bonds were subsequently sold to third parties within one year after the initial issue date.

The stock exchange test

- 2.26 Another way in which bonds differ from closely held debt is that they can be publicly traded. One of Australia’s public offer tests is that bonds which are “listed on a stock exchange” qualify for the exemption.
- 2.27 We suggest that New Zealand could adopt a similar stock exchange qualification. In many cases a stock exchange’s listing requirements could help ensure that the bonds were publicly traded and priced at an arm’s-length rate.

⁵A syndicated loan is a loan offered by a group of lenders (called a syndicate) who work together to provide funds for a single borrower.

2.28 As a stand-alone qualification, a stock exchange test would be easier to verify than a widely held test, but may not offer as much protection. This is because a company could emulate a closely held loan by listing bonds on a stock exchange but then issue them to just one or a few parties. For this reason bonds issued through a private placement would need to be specifically excluded from the concessionary rate of AIL.

Safeguards

2.29 As a further safeguard, the widely held, and stock exchange tests would need to be supported by specific exclusions to make it more difficult to reclassify closely held debt in order to qualify for the exemption. The zero rate of AIL would be denied if:

- The bonds are issued through a private placement that is limited to a select group of investors as opposed to a public offering that is open to all investors. The concern is that such bonds could be used in place of a loan or a syndicated loan.
- The bonds are not openly advertised to the target market during the book-build process.
- The bonds are an “asset-backed” security – that is, any security where the interest payments are financed by cashflows from a pool of financial assets, such as mortgages. The concern with these securities is that they can be used to package together a group of closely held loans and effectively shift the margin earned on these outside the New Zealand tax base. Note that this measure is not intended to exclude bonds that are simply “secured” against a collateral asset which the bond holder can claim in the case of default.

Questions for submissions

We would be interested to receive feedback on questions such as:

- Should AIL apply at a rate of zero on qualifying bonds?
- To what extent would this affect bond issuance and the way that businesses raise funds?
- Would this affect the decision to issue bonds offshore (as opposed to in New Zealand)?
- Which companies would make use of a zero rate of AIL for qualifying bonds?
- How can the proposed tests and safeguards be improved?

Appendix I

AUSTRALIA'S PUBLIC OFFER TEST EXEMPTION

(Adapted from Chapter 5 of the Australian Tax Office “Explanatory Memorandum on the *Taxation Laws Amendment Bill* (No. 2) 1997”)

There are four public offer tests. An Australian company (or an intermediary issuing bonds on an Australian company's behalf) needs to satisfy one of the tests to qualify for the withholding tax exemption.

1. Approach 10 financiers

Under the first public offer test, the debentures must be offered for issue to at least 10 persons who were each carrying on the business of providing finance, or investing or dealing in securities, as participants in financial markets. For example, if the Australian company offers its debentures to 10 banks or pensions funds operating in a financial market, the public offer test will be satisfied. It is a requirement of this test that the persons approached must not be known or suspected by the issuing company to be associates of each other. The company offering the debentures for sale does not need to undertake a detailed examination of the parties to whom the debentures are offered. It cannot, however, ignore companies that are generally known to be associates.

2. Offering debentures for issue to 100 potential investors

The second public offer test will be satisfied if at least 100 investors receive an offer of debentures for issue. This test is to accommodate financing operations undertaken in retail capital markets that are directed at individual investors and businesses. For example, this test may be satisfied by an issuer of debentures sending letters to persons who it may reasonably regard as having acquired debentures from time to time. Similarly, if offers are made to 100 customers of a stock broker who have previously purchased debentures this test will clearly be satisfied. Offers made to persons who have not previously purchased debentures from a stock broker but whom the broker has reason to believe may be interested in acquiring debentures or other securities will be counted for the purposes of the second public offer test. It will also be satisfied where an agent acting on behalf of the company approaches customers with an offer of the debentures for issue. The second test will not be satisfied where 100 persons receive an offer of debentures for issue who have not previously acquired debentures and in respect of whom the issuer has no reasonable basis for believing that they may be interested in acquiring debentures.

3. Listed on a stock exchange

The third public offer test will be satisfied if the company offers debentures for issue where the debentures have been accepted for listing by a stock exchange and the company has agreed with its dealers, managers or underwriters to have the debentures listed on the stock exchange following issue.

4. Quoted in a published source

The fourth public offer test will be satisfied if the debentures are offered for issue as a result of negotiations beginning with the company announcing in an electronic source or other sources, information monitored by capital markets, its intention to raise funds by issuing debentures. For example, the public offer test will be met if negotiations between an investor and the issuing company began because the investor became aware of the company's intention to raise funds after seeing an electronic information source or offering circular.

In relation to electronic quotation, the public offer test will be satisfied if the Australian company's offer of debentures for issue is quoted on an electronic financial information source such as Reuter financial services or Bloomberg. The details required to be in the electronic quotation are the name of the company issuing the debentures and the name of the programme. The quotation may include the names of the dealers or managers.

In relation to hardcopy publications, the debenture offer must be published in a publication monitored by financial markets as a source of information. For example, publication of an offer of debentures for issue in a leading financial newspaper in London or New York will satisfy this test. The test, however, will not be satisfied if the debenture offer is published in a source not used by financial markets for dealing in debentures. A prospectus or offering circular that is publicly available in capital markets will also meet this test.

Issues of debentures to associated persons always fail the public offer test

A company will fail the public offer test if it was aware (or had reasonable grounds to suspect), at the time of issue, that the debentures would be acquired by an associate of the company issuing the debentures.

Appendix II

DRAFT REGULATORY IMPACT STATEMENT

In accordance with the Regulatory Impact Analysis requirements for discussion documents, a draft regulatory impact statement has been prepared.

Executive summary

Approved issuers are required to pay a 2 percent levy on interest paid to non-residents on certain securities.⁶ This approved issuer levy (AIL) has been identified as a possible impediment to the development of New Zealand's corporate bond market. This impediment could be reduced by modifying AIL so that a zero percent rate (as opposed to the usual 2 percent rate) applies on interest paid in respect of certain qualifying bonds. An issues paper has been prepared to consult on this option.

A zero rate of AIL on qualifying bonds would be preferred to the status quo if the benefits of increased bond market development outweigh the costs of increased fiscal risk and the compliance costs associated with the legislative change. The issues paper aims to gather sufficient information to assess whether the suggested changes will meet this test.

Adequacy statement

An adequacy statement will be provided on the final regulatory impact statement.

Status quo and problem

Well-developed domestic capital markets have an important role in relation to economic growth, as they provide increased access to finance for New Zealand firms, capture the benefits of finance arrangements in New Zealand, and encourage firms to remain in or move to New Zealand. Bond markets have a part to play in well developed capital markets, as a well-functioning bond market has a number of important signalling and support roles which affect the performance of the capital markets, and the wider financial system.

New Zealand's overall financial system is patchy; a large, efficient and sound banking system sits alongside equity, venture capital and debt markets that in size, depth, liquidity and skill base are relatively underdeveloped. As at December 2008 the domestic bond market was the source of about 4 percent of all debt for non-financial businesses. The bulk of business debt was raised through domestic financial institutions (61 percent) and from offshore (26 percent from significant stakeholders and 9 percent from others).

New Zealand's corporate bond market is a minor part of our financial system, but has experienced strong recent growth. Since 2005 the total value of corporate bonds on issue has increased from \$12 billion dollars to \$23 billion dollars.

⁶ *If you pay interest to a non-resident lender and do not wish to deduct non-resident withholding tax (NRWT) from the interest payments, you have to apply to Inland Revenue to become an approved issuer. Instead of deducting NRWT, approved issuers must pay a 2% levy on the interest for those securities they register with Inland Revenue.*

The approved issuer levy (AIL) has been identified in forums such as the Jobs Summit as a possible tax impediment to the development of New Zealand's corporate bond market. This is because AIL increases the cost of issuing bonds to non-residents. For example, a non-resident investor who requires a 10 percent return to buy bonds from a New Zealand company would require the company to pay an interest rate of 10.2 percent to ensure that the investor gets the required return after AIL is deducted.

The impact of AIL on the domestic bond market could be exacerbated by the fact that it is possible for companies to establish foreign branches and borrow through these branches without paying AIL or (as an alternative) non-resident withholding tax (NRWT). On the other hand, interest payments on bonds issued in the domestic market are subject to either AIL or NRWT. This means that issuing bonds on the domestic market may be discouraged relative to issuing bonds through an offshore branch or borrowing directly through domestic banks.

Objectives

The issues paper is focused on investigating the extent to which AIL and NRWT may hinder bond market development and how this impediment could be removed without undermining New Zealand's ability to tax closely held debt (such as bank loans).

This tax focus is deliberate, as non-tax issues associated with the bond market are best considered through the Capital Market Development Taskforce, which is to produce a blueprint and action plan to develop New Zealand's capital markets more generally.

Should submissions contribute non-tax suggestions for how to improve the performance of domestic capital markets we will advise Ministers on these and pass them on to the Capital Market Development Taskforce.

Alternative options

The simplest solution that would enhance the domestic bond market would be to have a zero rate of AIL apply on all debt instruments between unrelated persons. However this is likely to have a very large fiscal cost, both directly in terms of lost AIL revenues and indirectly in terms of lost corporate tax revenues to the extent that it may encourage domestic lending activity (particularly from banks) to shift offshore.

Another option of attempting to remove all the existing exemptions to NRWT was, for technical reasons, not considered feasible.

Preferred option

The impediment could be reduced by modifying AIL so that a zero percent rate (as opposed to the usual 2 percent rate) applies on interest paid in respect of certain qualifying bonds. This is preferred to the alternative options outlined above because it is better targeted at reducing the cost of issuing bonds in New Zealand and would involve less fiscal cost and risk.

An issues paper has been prepared to consult on this option. We are interested in feedback on the following points:

Should AIL apply at a rate of zero on qualifying bonds?

A zero rate of AIL on qualifying bonds would be preferred to the status quo if the benefits of increased bond market development outweigh the costs of increased fiscal risk and compliance costs associated with the legislative change. The issues paper aims to gather sufficient information to assess whether the suggested changes will meet this test.

To what extent would this affect bond issuance and the way that businesses raise funds?

A zero rate of AIL on qualifying bonds would make it marginally cheaper to issue bonds to non-residents. This could lead to further growth in issuance and a better-functioning New Zealand bond market as it would reduce the cost of foreign funds and increase the pool of potential investors.

It is difficult to gauge the extent to which a zero rate of AIL would lead to increased bond issuance. Many factors influence bond issuing decisions besides interest costs. These include a desire to secure larger or longer-term finance, maintain a good credit rating, or gain access to a larger pool or different set of investors.

Similarly, in many cases it may remain suitable to lend from a single party (or syndicate), issue new equity, or fund the investment out of retained earnings, for reasons other than the relative cost of funds.

Would this effect the decision to issue bonds offshore (as opposed to in New Zealand)?

It may be cheaper for firms to issue debt in offshore markets, regardless of the impact of AIL. Compared with the New Zealand bond market, offshore markets can sometimes provide access to more favourable exchange and interest rates, and to a larger pool of investors. This means that some corporates may continue to raise much of their debt offshore if AIL were zero-rated, rather than issue new bonds into the New Zealand market.

Which companies would make use of a zero rate of AIL for qualifying bonds?

It is anticipated that a zero rate of AIL could lead to large corporates and existing bond issuers issuing additional bonds in New Zealand. It would be less likely to prompt smaller corporates to issue bonds for the first-time, because of the high set-up costs of becoming a bond issuer.

How can the proposed tests and safeguards be improved?

The amount that a zero rate of AIL increases fiscal risk and compliance costs depends on the design of the suggested changes.

Designing the zero rate of AIL is not a straightforward exercise. To keep fiscal risks at a manageable level it needs to ensure that the full rate of NRWT or AIL still applies to interest paid on closely held debt. Otherwise, there could be an increased incentive for loans to be made directly from offshore (for example, by a foreign bank). In such cases, the margin earned on the loan would no longer be subject to New Zealand tax. This could pose a significant fiscal risk to New Zealand because of the importance of the banking sector to our corporate tax base.

Rather than requiring those making submissions to anticipate what level of risk is acceptable and how this risk can be managed, the issues paper outlines a specific suggestion for them to respond to. Submissions can then focus on how the suggested tests and safeguards could be improved to increase uptake and reduce uncertainty and compliance costs.

Implementation and review

The preferred option could be implemented in the next available tax bill. Administration of the new rate of AIL could be carried out by Inland Revenue in accordance with existing practices for administering the approved issuer levy and non-resident withholding tax.

If the preferred option is implemented, officials plan to monitor changes in bond market activity and discuss with market participants how well the new rules are working. Any necessary corrections or improvements could be included in a subsequent tax bill.

Consultation

Consultation will be conducted through public submissions and meetings with interested parties in accordance with the generic tax policy process. We expect to receive submissions from banks, large corporates, market participants and tax practitioners.

We would be interested to receive feedback on questions such as:

Should AIL apply at a rate of zero on qualifying bonds?

To what extent would this affect bond issuance and the way that businesses raise funds?

Would this affect the decision to issue bonds offshore (as opposed to in New Zealand)?

Which companies would make use of a zero rate of AIL for qualifying bonds?

How can the suggested tests and safeguards be improved?