AMP CAPITAL

18 April 2017

Deputy Commissioner, Policy and Strategy
Policy and Strategy
Inland Revenue
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Wellington 6140

Email: policy.webmaster@ird.govt.nz

Dear Deputy Commissioner

Submission on "BEPS - strengthening our interest limitation rules"

We are writing to submit on the Government Discussion Document "BEPS – Strengthening our interest limitation rules" (the "discussion document"). We appreciate the opportunity to submit on this discussion document.

AMP Capital Investors Limited (AMP Capital) is a Global Infrastructure manager 85% owned by AMP Limited, a company dual listed on NZX and ASX. AMP Capital manages an interest in Powerco NZ Holdings Limited (PNZHL) on behalf of Australian superannuation funds and other institutional investors. PNZHL is the holding company for Powerco Limited, which is New Zealand's second largest Electricity and Gas Distribution Company. Powerco Ltd owns infrastructure assets through which electricity and gas flow to residential customers.

Summary of submissions

- Reducing the effective gearing ratio through the exclusion of non-debt liabilities will unfairly impact appropriately highly geared industries such as regulated infrastructure industries.
- This is exacerbated by the inclusion of deferred tax liabilities in the calculation of the deductible debt limit which in asset intensive industries can be significant and which can be treated by financiers in debt covenants as akin to equity.
- The interest rate cap is a novel and untested approach that may cause inequities at the boundary. It is also unnecessary in light of the current and proposed transfer pricing rules and is inconsistent with internationally accepted transfer pricing requirements.
- In our view, the issue being addressed by the proposed interest rate cap is best solved through the application of the current and proposed transfer pricing rules.
- The proposed changes create an unequal playing field for foreign and New Zealand investors as they have a greater impact on foreign investors, and can harm local New Zealand investors who frequently invest alongside foreign investors.
- The proposed changes may negatively impact valuations of New Zealand assets which can impact both foreign and New Zealand investors.

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Background

AMP Capital appreciate that New Zealand needs to ensure that all businesses are subject to an appropriate tax burden. However, in this context, we note the OECD as part of its BEPS project acknowledges that special rules may be needed for infrastructure businesses given their long-term capital intensive nature and public benefit outcome. The proposals suggested in the discussion document however are likely to result in horizontal inequity between businesses based on the residency of their owners and it will have the greatest impact on long term infrastructure businesses especially those with regulated asset bases which are supported by overseas capital. Further, a series of recent changes to the NZ thin capitalisation rules have already significantly reduced the perceived tax benefits that these measures are once again seeking to curtail.

Treatment of non-debt liabilities - Introduction of an arm's length fall back

The discussion document proposes changes in the current thin capitalisation rules to be based on assets net of non-debt liabilities rather than total assets. We consider the existing 60% gearing ratio to be too low for public benefit infrastructure. Powerco's Australasian peers in the regulated transmission and distribution sector have consistently maintained an average gearing above 60%. The impact of moving to a net asset calculation will reduce the total asset ratio even further.

Measurement date for assets and liabilities

The proposal to require quarterly or daily measurement risks imposing significant and unnecessary compliance costs given that the calculation is based on IFRS accounting values which may not be prepared on a quarterly basis. IFRS accounting requires certain complex calculations including impairment testing, fair value and marked to market calculations. To require these to be done solely for tax purposes at points in the year, or even daily, when they are not already being done for financial reporting purposes imposes significant additional and unnecessary compliance costs.

Interest rate cap – use transfer pricing principles instead

The discussion paper suggests a bolster to the asset based thin capitalisation rules in the form of an interest rate cap. This is a novel and untested approach. We consider that the cap on related party loans adds significant complexity, limits flexibility in raising debt capital, increases horizontal inequity between local and foreign owned businesses and when combined with the reduced debt to asset ratio makes New Zealand a uniquely complex thin capitalisation regime in the international community. In the longer run, we expect this would result in a higher cost of capital for New Zealand infrastructure assets, resulting in higher charges to end users and/or cost to Government.

The interest rate cap introduces a high risk of double taxation when dealing with most other jurisdictions which apply transfer pricing principles. For example, a circumstance could arise where the NZ interest rate cap is 6% while the Australian transfer pricing rules based on OECD principles require an arm's length rate of 8% to be returned as income. This scenario results in the inequitable outcome of the NZ interest deduction being capped at 6% and interest income of 8% being assessable in Australia.

The ability to utilise the mutual agreement process in our double tax treaties (MAP) helps avoid double taxation and supports the integrity of the global tax system. While thin capitalisation adjustments have always been unilateral, managing debt levels within the current safe harbour rules has been relatively straightforward. However, the combined impact of the thin capitalisation rules and the interest rate cap will make it much harder to avoid double taxation where interest is not deductible in New Zealand but assessable in the offshore jurisdiction.

These fundamental concerns can be addressed if the interest rate cap is replaced or supplemented by an arm's length debt pricing test relying on transfer pricing rules.

Alternative approaches

Paragraph 2.19 of the discussion paper notes that failure to address the perceived problems with the rules may mean an EBITDA based rule is adopted. We do not accept that an EBITDA based rule is the logical outcome of rejecting the interest rate cap. As identified by the discussion paper, there are also a number of problems with the EBITDA approach and as noted above, the OECD recognises that public benefit infrastructure has special characteristics that might mean an exemption from the EBITDA test is appropriate.

The discussion paper "New Zealand's taxation framework for inbound investment" published in June 2016 noted that "a priority for the Government is ensuring that New Zealand continues to be a good place to invest and for businesses to be based, grow and flourish"[1]. It our view imposition of an EBITDA based rule without an exemption for public benefit infrastructure risks failing that priority.

Further, in that paper the Government stated that it considered the use of non-resident withholding tax on related party lending as a "backstop to … income tax…minimising the potential for base erosion by [related party interest] payments"[2]. The OECD 2016 update[3] emphasised the difficulty for European jurisdictions in particular to apply withholding tax to interest payments. The EBITDA approach may make some sense in an environment like Europe where there is a limited application of non-resident withholding tax. However, the recent broadening and strengthening of New Zealand's non-resident withholding tax rules focused on closing a perceived gap in taxation of related party lending reduces the need for New Zealand to consider an EBITDA approach.

We submit that with series of recent amendments to the deductibility of interest on shareholder loans, the transfer pricing rules (current and proposed) are more than adequate in dealing with the appropriateness of interest rate charges, are well supported by a non-resident withholding tax backstop, and avoid the policy compromises caused by the interest rate cap.

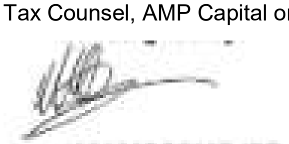
Implementation considerations

A common theme of recent law changes affecting interest deductions is the New Zealand Government focus on reducing the use of loans from equity investors. We wish to make you aware that where we have considered proposals to reduce our level of loans from equity investors in response to the law changes, a number of New Zealand tax provisions (e.g. general anti avoidance rule) have the potential to result in very significant New Zealand tax consequences when such loans are repaid. This is in addition to tax consequences in the foreign investors home jurisdiction (i.e. foreign exchange gains due to appreciation of the NZ dollar).

For these reasons, should our earlier comments on the appropriateness of the proposed amendments be put aside, we request that consideration be given to grandfathering existing arrangements, or at the least, providing relief where loans from equity investors are repaid.

General

We trust you find our comments useful. If you have any questions, please contact Kelly Heezen, Senior Tax Counsel, AMP Capital on 9(2)(a) [redacted] or at kelly.heezen@ampcapital.com.



Michael Cummings
AMP Capital, Head of Australian and New Zealand Infrastructure Funds

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[1] Page 3, New Zealand's taxation framework for inbound investment, June 2016
[2] Page 15, New Zealand's taxation framework for inbound investment, June 2016
[3] Limiting Base Erosion Involving Interest Deductions and Other Financial Payments Action 4 – 2016 Update