

Hon Stuart Nash, Minister of Revenue

Information Release

Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019

September 2019

Availability

This information release is available on Inland Revenue's Tax Policy website at <http://taxpolicy.ird.govt.nz/publications/2019-ir-cab-leg-19-sub-0115/overview>.

Documents in this information release

1. IR2019/350 – Tax policy report: Setting the deemed rate of return for the 2018–19 income year: Order in Council for the Cabinet Legislation Committee (15 July 2019)
2. BN2019/377 – Briefing note: Speaking notes for LEG Cabinet Committee (8 August 2019)
3. LEG-19-SUB-0115 – Cabinet paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019 (20 August 2019)
4. LEG-19-MIN-0115 – Minute: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019 (20 August 2019)

Additional information

The Cabinet paper was considered by the Cabinet Legislation Committee on 20 August 2019 and confirmed by Cabinet on 26 August 2019.

One attachment to the Cabinet paper is not included in this information release as it is publicly available:

- Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019.

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

- 9(2)(a) to protect the privacy of natural persons, including deceased people

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POLICY AND STRATEGY

Tax policy report: Setting the deemed rate of return for the 2018–19 income year: Order in Council for the Cabinet Legislation Committee

Date:	15 July 2019	Priority:	Medium
Security level:	In Confidence	Report number:	IR2019/350

Action sought

	Action sought	Deadline
Minister of Revenue	Agree to recommendations. Approve and lodge the attached Cabinet paper and advice sheet to Cabinet Legislation Committee with the Cabinet Office.	10am, Thursday, 15 August 2019

Contact for telephone discussion (if required)

Name	Position	Telephone
s 9(2)(a)	Team Leader	s 9(2)(a)
s 9(2)(a)	Assistant Policy Analyst	

15 July 2019

Minister of Revenue

Setting the deemed rate of return for the 2018–19 income year: Order in Council for the Cabinet Legislation Committee

Background

1. The Income Tax Act 2007 requires the deemed rate of return under the foreign investment fund (FIF) rules for each income year be set by Order in Council.
2. New Zealand's FIF rules tax New Zealand residents on attributed income from non-controlling investments in foreign companies, life insurance policies, and certain superannuation schemes. Since 1 April 2014, most interests in foreign superannuation schemes are taxed on transfer, rather than under the FIF rules.
3. The Income Tax Act 2007 provides a number of different methods to calculate FIF income (or loss) for tax purposes, one of which is the deemed rate of return method. An investor must use the deemed rate of return method where:
 - the interest consists of certain non-ordinary shares that have debt characteristics; and
 - the comparative value method cannot be used because the end-of-year market value of the interest cannot be determined.
4. Under the deemed rate of return method, income from a FIF is calculated each year by multiplying the opening book value of the investment by the rate set annually by Order in Council.
5. An Order in Council is now required to set the deemed rate of return for the 2018–19 income year.

Calculation

6. The method for calculating the annual deemed rate of return was established and approved in 1994 (*CAB (94) M 35/3 C(vi)* refers) and published in Inland Revenue's October 1994 *Tax Information Bulletin*. The calculation involves taking an average of the five-year "risk-free" Government bond rates at the end of each quarter of the income year and adding a risk premium margin of four percentage points. If the last day of the quarter falls on a weekend or statutory holiday, the rate on the next business day is used.
7. Officials recommend that the current method for calculating the deemed rate of return be used again for the 2018–19 income year. It is a simple way of approximating the expected return on foreign equities, incorporating a four percentage-point risk premium over the return on "risk-free" debt, such as Government stock. The method has been used for every income year since 1994.
8. The average of the quarterly five-year Government bond interest rates for the 2018–19 income year is 1.86%. This means that the deemed rate of return for the 2018–19 income year will be 5.86% (1.86% plus four percentage points). This is a decrease from last year's deemed rate of return, which was 6.44%.

Regulatory Impact Analysis

9. A Regulatory Impact Analysis is not required because no policy decision is being sought. The deemed rate of return has been calculated in accordance with a formula that was approved by Cabinet in 1994 (*CAB (94) M 35/3 C(vi)* refers).

Timing

10. The Order in Council will enable taxpayers using the deemed rate of return method to calculate their FIF income for the 2018–19 income year and will therefore effectively apply from 1 April 2018. However, because the deemed rate calculation is based on the 2018–19 five-year Government bond rates, the Order in Council will have retrospective effect.
11. A waiver of the 28-day rule for this regulation coming into force will not be sought this year. This departs from the approach taken in previous years.

Cabinet paper and associated materials

12. The Cabinet paper and the advice sheet for the Order in Council have been prepared and are attached to this report. These two documents should be signed and referred to the Cabinet Office by 10am, Thursday, 15 August 2019, for consideration at the Cabinet Legislation Committee's meeting on Tuesday, 20 August 2019.
13. The Parliamentary Counsel Office will provide copies of the finalised Order in Council directly to the Cabinet Office.
14. A media statement will be issued once the Order in Council has been made.

Proactive Release

15. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers within 30 working days of Cabinet making final decisions, subject to minor redactions under the Official Information Act 1982.

Recommended action

We recommend that you:

16. **Agree** to the release of the attached Cabinet paper and associated minutes, within 30 working days of Cabinet making final decisions.

Agreed/Disagreed

17. **Approve and lodge** the attached Cabinet paper and advice sheet to the Cabinet Office by 10am, Thursday, 15 August 2019, for consideration at the Cabinet Legislation Committee meeting on Tuesday, 20 August 2019.

Approved and lodged

s 9(2)(a)

Team Leader
Policy and Strategy

Hon Stuart Nash
Minister of Revenue
/ / 2019

Briefing note

Reference: BN2019/377

Date: 8 August 2019

To: Revenue Advisor, Minister of Revenue – s 9(2)(a)
Private Secretary, Minister of Revenue – s 9(2)(a)

cc: Naomi Ferguson, Commissioner
Emma Grigg, Acting Deputy Commissioner
Phil Whittington, Acting Chief Economist
Melody Guy, Acting Policy Director
David Carrigan, Policy Director
s 9(2)(a)

From: Paul Kilford
s 9(2)(a)

Subject: **Speaking notes for LEG Cabinet Committee meeting on 20 August 2019**

Background

1. This briefing note contains speaking notes for the Minister of Revenue to use at the Cabinet Legislation Committee meeting on 20 August 2019.
2. The Cabinet Legislation Committee will consider an Order in Council to set the deemed rate of return for the 2018–19 income year (report IR2019/350 refers).
3. The deemed rate of return is set by the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019.

Paul Kilford
Acting Policy Manager
s 9(2)(a)

s 9(2)(a)

Speaking notes

Cabinet Legislation Committee (LEG)
20 August 2019

Paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019

Proposal

- The proposal is that the Cabinet Legislation Committee authorise the submission to the Executive Council of the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019.
- The formula for setting the rate was approved by Cabinet in 1994 and has been used ever since.
- It is proposed that the deemed rate of return be set at 5.86% for the 2018–19 income year. This is a reduction from the rate for the 2017–18 income year of 6.44%.
- The equivalent Order for the 2017–18 year should be revoked but continue to have effect for that income year.

Background

- The foreign investment fund (FIF) rules tax New Zealand residents on certain non-controlling investments in foreign companies, foreign superannuation schemes, and life insurance policies.
- The deemed rate of return method is one of five methods for calculating FIF income. The deemed rate of return method is used where:
 - the FIF interest consists of certain non-ordinary shares with debt-like properties; and
 - the taxpayer cannot use the comparative value method because the market value of the FIF interest cannot be determined at the end of the income year.

Calculation

- The formula for calculating the deemed rate of return is:
 - the average of the five-year “risk-free” government bond rates at the end of each quarter of the income year + a risk premium margin of four percentage points.

Previous rates

- 2017–18 rate: 6.44%
- 2016–17 rate: 6.28%
- 2015–16 rate: 6.77%

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

INCOME TAX (DEEMED RATE OF RETURN ON ATTRIBUTING INTERESTS IN FOREIGN INVESTMENT FUNDS, 2018–19 INCOME YEAR) ORDER 2019

Proposal

1. This paper proposes that Cabinet Legislation Committee authorise the submission to the Executive Council of the attached Order in Council, which will set the deemed rate of return at 5.86% for attributing interests in foreign investment funds for the 2018–19 income year.

Background

2. New Zealand's foreign investment fund (FIF) rules tax New Zealand residents on attributed income from non-controlling investments in foreign companies, life insurance policies, and certain superannuation schemes. The Income Tax Act 2007 provides a number of methods for calculating the amount of income or loss to be attributed to the taxpayer. One of these methods is the deemed rate of return method.
3. The deemed rate of return method is used to calculate FIF income or loss for non-ordinary shares with debt-like properties, if the market value of the FIF interest cannot be determined at the end of the income year.
4. Under the deemed rate of return method, income from an FIF is calculated each year by multiplying the opening book value of the investment by a deemed rate set annually by Order in Council.
5. The method for calculating the annual deemed rate of return was established and approved in 1994 (*CAB Min (94) 35/3 C(vi)* refers) and published in Inland Revenue's October 1994 *Tax Information Bulletin*. The calculation involves taking an average of the five-year "risk-free" Government bond rates at the end of each quarter of the income year and then adding a risk premium margin of four percentage points.
6. The current method is a suitable way of approximating the expected return on foreign equities and has been used for every income year since 1994.

Comment

7. The average of the quarterly five-year Government bond interest rates for the 2018–19 income year is 1.86%. The attached Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019

therefore sets the deemed rate of return for the 2018–19 income year at 5.86% (1.86% plus four percentage points) in accordance with the current method of calculation. This is a decrease from last year's deemed rate of return, which was 6.44%.

8. The Order also revokes the previous year's corresponding Order, which set the deemed rate of return for the 2017–18 income year.

Timing and 28-day rule

9. The 28-day rule requires that regulations must not come into force until at least 28 days after they have been notified in the *New Zealand Gazette*.
10. Although the attached Order in Council is to apply retrospectively, a waiver for the 28-day rule is not being sought. This is a departure from the approach taken for making this regulation in previous years.

Consultation

11. The Treasury has been consulted in the preparation of this paper and agrees with its recommendations.

Human rights

12. The attached Order in Council complies with:
 - a) the principles of the Treaty of Waitangi;
 - b) the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - c) the principles and guidelines set out in the Privacy Act 1993;
 - d) relevant international standards and obligations; and
 - e) the guidelines in the Legislation Advisory Committee report *Guidelines on Process and Content of Legislation* (May 2001).

Legislative implications

13. The proposal of this Cabinet paper is that the attached Order in Council be submitted to the Executive Council.

Regulatory Impact Analysis

14. A Regulatory Impact Analysis is not required because no policy decision is being sought. The deemed rate of return has been calculated in accordance with a formula that was approved by Cabinet in 1994 (*CAB Min (94) 35/3 C(vi)* refers).

Regulations Review Committee

15. There are no anticipated grounds for the Regulations Review Committee to draw the Order in Council to the attention of the House.

Certification by Parliamentary Counsel

16. The Parliamentary Counsel Office has certified that the attached Order in Council is in order for submission to Cabinet.

Publicity

17. Once the Order in Council is made, a media statement will be issued.

Proactive Release

18. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers within 30 working days of Cabinet making final decisions, subject to minor redactions under the Official Information Act 1982.

Recommendations

I recommend that the Cabinet Legislation Committee:

1. **note** that the attached Order in Council sets a deemed rate of return of 5.86% for foreign investment fund interests for the 2018–19 income year;
2. **note** that the attached Order in Council revokes the previous year's corresponding Order and regulations prescribing the deemed rate of return for the 2017–18 income year;
3. **authorise** the submission to the Executive Council of the attached Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019;
4. **note** that the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019 comes into force on 26 September 2019.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue



Cabinet Legislation Committee

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019

Portfolio **Revenue**

On 20 August 2019, the Cabinet Legislation Committee:

- 1 **noted** that the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019 (the Order) sets a deemed rate of return of 5.86 percent for foreign investment fund interests for the 2018–19 income year;
- 2 **noted** that the above Order in Council revokes the previous year’s corresponding Order and regulations prescribing the deemed rate of return for the 2017–18 income year;
- 3 **authorised** the submission to the Executive Council of the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2018–19 Income Year) Order 2019 [PCO 22244/2.0];
- 4 **noted** that the Order comes into force on 26 September 2019.

Vivien Meek
Committee Secretary

Present:

Rt Hon Jacinda Ardern
Rt Hon Winston Peters
Hon Chris Hipkins (Chair)
Hon Andrew Little
Hon David Parker
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Damien O’Connor
Hon Tracey Martin
Hon Julie Ann Genter
Hon Eugenie Sage
Hon Ruth Dyson (Senior Government Whip)

Officials present from:

Office of the Prime Minister
Officials Committee for LEG

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