



## POLICY AND REGULATORY STEWARDSHIP

**Tax policy report:** **Cabinet paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2022-23 Income Year) Order 2023**

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<b>Date:</b>	10 May 2023	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2023/149

### Action sought

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	<b>Action sought</b>	<b>Deadline</b>
Associate Minister of Revenue	<p><b>Agree</b> to set the deemed rate of return as set out in the report</p> <p><b>Sign</b> and <b>refer</b> the attached paper to the Cabinet Office for consideration at the LEG meeting on 8 June 2023</p>	25 May 2023

### Contact for telephone discussion (if required)

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<b>Name</b>	<b>Position</b>	<b>Telephone</b>
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10 May 2023

Associate Minister of Revenue

## **Cabinet paper: Income tax (Deemed Rate of Return on Attributing Interests in Foreign Investment funds, 2022-23 Income Year) Order 2023**

### **Purpose**

1. This report informs you about the required annual change to the deemed rate of return on attributing interests in foreign investment funds. Attached is a Cabinet paper that recommends an Order in Council be made to set the deemed rate of return for the 2022-23 income year.

### **Background**

2. The Income Tax Act 2007 requires the deemed rate of return under foreign investment fund (FIF) rules for each income year to be set by Order in Council.
3. 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.
4. The Act provides different methods to calculate FIF income or losses for tax purposes, one of which is the deemed rate of return method. An investor must use the deemed rate of return where:
  - 4.1 The interest consists of certain non-ordinary shares that have debt characteristics; and
  - 4.2 The comparative value method cannot be used because the end-of-year market value of the interest cannot be determined.
5. Under the deemed rate of return method, income from a FIF is calculated each year by multiplying the opening value of the investment by the rate set annually by Order in Council.
6. An Order in Council is now required to set the deemed rate of return for the 2022-23 income year.

### **Calculation**

7. The method for calculating the annual deemed rate of return was established and approved in 1994 (*CAB (94) M 35/3 C(vi)* refers). The calculation involves taking an average of the five-year "risk-free" Government bond rate 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 a quarter falls on a weekend or statutory holiday, the rate on the next business day is used.
8. Officials recommend that the current method for calculating the deemed rate of return be used again for the 2022-23 income year. It is a simple way of approximating the expected return on foreign equities, incorporating a risk premium of four percentage points above the return on "risk-free" debt such as Government bonds. The method has been used for every income year since 1994.

9. The average of the quarterly five-year Government bond interest rates for the 2022–23 income year is 4.15%. This means that the deemed rate of return for the 2022–23 income year will be 8.15% (4.15% plus four percent). This is an increase from last year's deemed rate of return, which was 6.01%.
10. Despite an increase of 2.14%, the deemed rate of return method is used by a very small number of taxpayers, therefore, this change will have no quantifiable fiscal impact.

### **Regulatory Impact Analysis**

11. A Regulatory Impact Analysis is not required for this Cabinet paper 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**

12. Because the deemed rate of return is based on five-year Government bond rates from across the year for which the rate applies, it must always be calculated after the end of the income year but apply retrospectively from the beginning of that year.
13. This Order in Council will enable taxpayers using the deemed rate of return method to calculate their FIF income for the 2022–23 income year and therefore needs to apply retrospectively from 1 April 2022.
14. Officials recommend that a waiver of the 28-day rule for regulations is sought for this Order in Council. Taxpayers that use the deemed rate of return are not able to use the old rate to file a return for the 2022–23 year; they must wait for the new rate to come into force. A waiver would be taxpayer-friendly and beneficial to the Government, as without a waiver some taxpayers would have to wait an extra 28 days to file a return because they are waiting on the rate to come into force.
15. The attached Cabinet paper is drafted on the basis that a waiver is sought for the Order in Council. This will mean the Order comes into force on 16 June 2023. If you do not agree to recommend a waiver, we will supply you with an updated Cabinet paper.

### **Cabinet paper and associated materials**

16. The Cabinet paper and the advice sheet for the Order in Council are attached to this report. These should be signed and referred to the Cabinet Office by 10am, Thursday June 1, 2023, for consideration at the Cabinet Legislation Committee's meeting on 8 June 2023.
17. The Parliamentary Council Office will provide copies of the finalised Order in Council directly to the Cabinet Office.
18. The rate will be published on the Inland Revenue website once the Order in Council has been made.

### **Consultation**

19. The Treasury was consulted on the Cabinet paper and agrees with its recommendation.

**Proactive release**

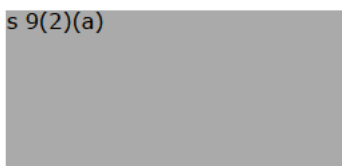
20. The Cabinet paper, associated minutes, and key advice papers should be proactively released within 30 working days of Cabinet making final decisions, subject to minor redactions under the Official Information Act 1982.

**Recommended action**

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21. **agree** for the Income Tax (Deemed rate of Return on Attributing Interests in Foreign Investment Funds, 2022-23 Income Year) Order 2023 to set the deemed rate of return for the 2022-23 income year at 8.15%.  
Agreed/Not agreed
22. **agree** for the Order to have a commencement date of 16 June 2023, requiring a waiver of the 28-day rule to be agreed to by Cabinet.  
Agreed/Not agreed
23. **direct** officials to provide drafting instructions to the Parliamentary Counsel Office  
Directed/Not directed
24. **sign** and **refer** the attached Cabinet paper to the Cabinet Office by 10am Thursday 1 June 2023 for consideration at the Cabinet Legislation Committee meeting on Thursday 8 June 2023.  
Approved/Not approved
25. **agree** to the release of the Cabinet paper, associated minutes, and key advice papers within 30 working days of Cabinet making final decisions.  
Agreed/Not agreed
26. **refer** a copy of this report to the Minister of Revenue for their information.  
Referred/Not referred

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**Paul Fulton**  
Principal Policy Advisor  
Policy and Regulatory Stewardship

**Hon Dr Deborah Russell**  
Associate Minister of Revenue  
/ /2023