
Draft legislation for stapled stock amendments to Income Tax Act 2007

Explanatory Note

Principal amendment

New section FA 2B defines the concept of a stapled debt security, being a financial arrangement that provides funds to a company, that would otherwise give rise to deductions and that can ordinarily only be disposed of together with a share in the issuing company or in another company. The new section provides that a security that is a stapled debt security is treated as a share and the issuing company is denied a deduction for expenditure or loss incurred under the security. The new section also provides that the stapled debt security and the share to which it is stapled are treated as a single share for the purposes of various provisions in the Act that define and apply specific treatments to shares bearing a fixed rate of dividend (or having an equivalent consequence). The new provision does not apply to debt securities that are stapled before 25 February 2008.

Related amendments

Various provisions in the Act are amended in conjunction with the introduction of the new section FA 2B. Stapled debt securities are to be treated in the same way as debentures that are recharacterised as shares under section FA 2, by virtue of amendments to be made to section CD 22(9) (relating to returns of capital on off-market share cancellations), section DP 8 (which relates to qualifying debentures issued by certain forestry companies), sections EX 5(5)(c), EX 9(6)(c), and EX 30(6)(c) (which relate to various aspects of the CFC and FIF regimes) and section HD 14(2)(a) (which relates to companies being treated as agents of debenture holders). A new section DB 10B is introduced to confirm the denial of any deduction for interest or other expenditure. Various amendments are made to the definitions in section YA 1, including the insertion of new definitions of "stapled debt security", "debt security" and "stapled". Other consequential amendments ensure that stapled debt securities are treated in a similar way to debentures recharacterised as shares under section FA 2, for the purposes of certain definitions in section YA 1.

Section 90A of the Tax Administration Act 1994 is amended to authorise the Commissioner to issue determinations for the purposes of the new section FA 2B, determining the extent to which a financial arrangement provides funds to an issuing company, in the same way as the Commissioner can provide determinations for the purposes of the thin capitalisation rules in subpart FE of the Act.

Principal amendment

The following section is inserted after section FA 2:

FA 2B Stapled debt securities

When subsection (2) applies

- (1) **Subsection (2)** applies when—
- (a) a company has issued a debt security (**stapled debt security**); and
 - (b) the stapled debt security is stapled to a share in the company or another company.

Stapled debt treated as equity

- (2) The stapled debt security is treated as a share issued by the company and the company is denied a deduction under **section DB 10B** for expenditure or loss incurred under the security.

When subsection (4) applies

- (3) **Subsection (4)** applies when stapled debt security treated as a share under **subsection (2)** is stapled to another share.

Stapled securities aggregated

- (4) The shares are treated as a single share for the purposes of applying—
- (a) the definition of **non-participating redeemable share** in **section CD 22(9)** (Returns of capital: off-market share cancellations);
 - (b) the definition of **fixed rate share** in **section LL 9** (Some definitions), which relates to **subpart LL** (Underlying foreign tax credits (UFTC)) and **sections EX 46** (Limits on choice of calculation methods) and **FE 21** (Banking group's New Zealand net equity); and
 - (c) **paragraphs (a) to (d)** of the definition of **fixed rate share** in **section YA 1**.

Some definitions

- (5) In this section—
- (a) **debt security** means a financial arrangement that—
 - (i) provides funds to the company; and
 - (ii) gives rise to an amount for which the company would have a deduction but for this section; and
 - (iii) the amount does not arise only from either a movement in a currency exchange rate or a non-contingent fee:
 - (b) a debt security is **stapled** to a share if the debt security can, or ordinarily can, be disposed of only together with the share.

Section 90A Tax Administration Act 1994

- (6) For a determination on whether a financial arrangement provides funds, see section 90A of the Tax Administration Act 1994.

Exclusion: stapled before 25 February 2008

- (7) This section does not apply if the debt security was stapled to the share before 25 February 2008.

Defined in this Act: amount, company, debt security, deduction, financial arrangement, non-contingent fee, share, stapled

Related amendments

1. Returns of capital: off-market share cancellations

In **section CD 22(9)**, in paragraph (b)(ii) of the definition of **non participating redeemable share**, the words "or section FA 2B(2) (Stapled debt securities)" is added.

2. New section inserted

After section DB 10, the following is inserted:

DB 10B Interest or expenditure connected to stapled debt security

No deduction

- (1) A company issuing a stapled debt security is denied a deduction under **section FA 2B** (Stapled debt securities) for—
 - (a) interest payable under the security; or
 - (b) expenditure or loss incurred in connection with the security; or
 - (c) expenditure or loss incurred in borrowing the money secured by or owing under the security.

Relationship with sections DB 5 to DB 8

- (2) This section overrides **sections DB 5 to DB 8**.

Link with subpart DA

- (3) This section overrides the general permission.

Defined in this Act: deduction, general permission, interest, pay, stapled debt security

3. Forestry business on land bought from the Crown, Maori owners, or holding company: no deduction

In **section DP 8(3)**, the word ", does" is replaced by the words "and **section FA 2B** (Stapled debt securities) do".

4. Direct control interests

In **section EX 5(5)(c)**, after the words "**section FA 2** (Recharacterisation of certain debentures)", the words ", **FA 2B** (Stapled debt securities)" are inserted.

5. Direct income interests

In **section EX 9(6)(c)**, after the words "**section FA 2** (Recharacterisation of certain debentures)", the words ", **FA 2B** (Stapled debt securities)" are inserted.

6. Direct income interest in FIFs

In **section EX 30(6)(c)**, after the words "**section FA 2** (Recharacterisation of certain debentures)", the words ", **FA 2B** (Stapled debt securities)" are inserted.

7. Company issuing debentures

In **section HD 14(2)(a)** is replaced by the following:

- (a) it is a profit-related debenture or substituting debenture to which **section FA 2** (Recharacterisation of certain debentures) applies or a stapled debt security to which **section FA 2B** (Stapled debt securities) applies; or

8. Definitions

- (1) This section amends **section YA 1**.
- (2) After the definition of **debenture holder**, the following is inserted:
 "**debt security** is defined in **section FA 2B(5)** (Stapled debt securities) for the purposes of that section"
- (3) In the definition of **excluded fixed rate security**, after the words "substituting debenture", the words "or stapled debt security" are inserted.
- (4) In the definition of **market value circumstance**, in **paragraph (a)(ii)**, after the words "**section FA 2** (Recharacterisation of certain debentures)", the words ", or **FA 2B** (Stapled debt securities)" are inserted.
- (5) In the definition of **share**, after **paragraph (b)**, the following is inserted:
 "(bb) includes a stapled debt security to which **section FA 2B(2)** (Stapled debt securities) applies"
- (6) After the definition of **standing timber**, the following is inserted:
 "**stapled** is defined in **section FA 2B(5)** (Stapled debt securities) for the purposes of that section"
 "**stapled debt security** means a financial arrangement to which **section FA 2B(2)** (Stapled debt securities) applies"

- 9. (a) In section 90A(1) of the Tax Administration Act 1994, after the words "purpose of", the words "section FA 2B or" are inserted.
- (b) In section 90A(2) of the Tax Administration Act 1994, after the words "purposes of", the words "section FA 2B or" are inserted.