

Regulatory Impact Statement

Non-resident film renters' tax

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

The question in this Statement is whether the non-resident film renters' tax rules in the Income Tax Act 2007 are necessary and, if not, whether the rules should be replaced by non-resident withholding tax (NRWT).

The non-resident film renters' tax was introduced in 1928 because of the difficulties in accurately determining the net profit derived by non-residents from renting out films in New Zealand. However, there is no longer a sound policy rationale for retaining the non-resident film renters' tax rules.

Public consultation was undertaken as part of the Government discussion document, *New Zealand's International Tax Review: a direction for change*, released in December 2006 and three submissions were received on the proposal. Recently, officials have been in contact with the submitters about the proposed change and they raised no additional points to their submissions.

Other than set out in this Disclosure Statement and the broader Regulatory Impact Statement, no significant gaps, assumptions, dependencies, constraints, caveats or uncertainties have been identified.

In preparing this Statement, we have consulted with the Treasury, which agrees with our analysis.

The proposed change may impose some compliance costs for New Zealand customers who make payments to non-resident film renters for renting and exhibiting film purposes in New Zealand. New Zealand customers would need to withhold tax for the non-resident film renters and some may potentially need to re-negotiate existing contracts and re-configure systems for the deduction of NRWT. But, overall and also in the long term, the change would simplify the New Zealand income tax rules applying to non-residents and reduce compliance costs on non-resident companies by removing their filing responsibility in New Zealand. The change does not affect the local film production industry.

The proposed change does not impair private property rights, reduce market competition, provide disincentives to innovate and invest or override common law principles.



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STATUS QUO AND PROBLEM DEFINITION

1. At present, 10 percent of the gross receipts derived by non-residents from renting out films in New Zealand are deemed to be assessable income under section CV 17 of the Income Tax Act 2007. Under section DW 3, a non-resident film renter is not allowed a deduction in relation to this income. The rate of tax that is applied is the rate of tax applicable to the non-resident. Because the non-resident is invariably a company, this means that non-resident film renters are generally subject to an effective tax rate of 2.8 percent on their gross receipts (i.e. 28 percent of 10 percent).
2. Income subject to this rule is not included in the income of the non-resident film renter under any other provision in the Act. Importantly, this income is excluded from the definition of non-resident passive income and is therefore not subject to non-resident withholding tax (NRWT).¹
3. The rule for taxing non-resident film renters has existed in various forms since 1928. The rule was originally enacted because of the difficulties in accurately determining the net profit derived by non-residents from renting out films in New Zealand. Given NRWT is now well-established and could apply to such income, there is no longer a sound policy rationale for having separate tax rules for non-resident film renters.
4. This Statement considers whether the Income Tax Act should be amended to remove the separate tax rules for non-resident film renters.

OBJECTIVES

5. The main objective is to review whether the existing non-resident film renters' tax rules are necessary and, if not, whether the rules should be replaced by NRWT.

REGULATORY IMPACT ANALYSIS

6. The options that we have identified are to retain the status quo or to repeal the provisions relating to non-resident film renters' tax so that NRWT applies to amounts derived by non-resident film renters.
7. The non-resident film renters' tax is an historical anachronism. It appears that the non-resident film renters' tax was not replaced in 1964 when NRWT was introduced because of the 1948 double tax agreement (DTA) between United States and New Zealand. That DTA prevented New Zealand taxing the income of United States film renters except to the extent allowed under the existing non-resident film renters' tax. The 1982 DTA between New Zealand and the United States (replacing the 1948 DTA) and the current DTA (in force from November 2010) contains no similar restriction on New Zealand's ability to tax income derived from New Zealand by the United States-resident film renters.
8. The preferred option is to repeal the existing provisions relating to non-resident film renters' tax so that NRWT could apply. This would rationalise and simplify the New Zealand income tax rules applying to non-residents and provide consistency with other tax treatments.

¹ NRWT is a broad set of withholding taxes on interest, dividends and royalties derived from New Zealand by non-residents.

Also, this approach is in line with how other countries, such as Australia, tax amounts derived by non-resident film renters.

9. Practically all amounts subject to the non-resident film renters' tax would come within the royalty definitions in the Income Tax Act 2007 and in New Zealand's DTAs. Hence, such amounts would be subject to NRWT if non-resident film renters' tax is repealed.²

10. Under this option, NRWT at variable rates would apply in accordance with DTAs between New Zealand and other countries, which limit the amount of NRWT that New Zealand can charge on royalties. The DTA royalty rate is generally 10 percent. However, the rate under the United States and Australia DTAs is five percent, which would apply to many non-resident film renters. The NRWT rate of 15 percent applies if there is no applicable DTA.

11. This option will result in the following estimated increase in tax revenues, with a corresponding impact on the operating balance:

Vote Revenue Minister of Revenue	\$ millions increase / (decrease)				
	2010/11	2011/12	2012/13	2013/14	2014/15 &outyears
Crown Revenue and Receipts: Tax Revenue	–	–	5.000	5.000	5.000

12. No social, environmental or cultural costs are expected to arise under this option. Also, no significant behavioural changes by non-resident film renters are expected to arise. NRWT on film rental payments derived from New Zealand by non-residents would generally be creditable in the home country of the non-resident film renter.

13. There will be some compliance costs for New Zealand customers who make payments to non-resident film renters for renting or exhibiting film purposes in New Zealand. New Zealand customers will have to withhold tax for the non-resident film renters from the 2012–13 income year and may potentially re-negotiate existing contracts and re-configure systems for the deduction of NRWT. Because it involves making deductions from gross payments at a flat rate, NRWT is a relatively simple tax to comply with. Some non-resident film renters may also face increased compliance costs to re-negotiate existing contracts but this will be partially offset by the removal of filing responsibility in New Zealand.

14. The proposed change will not affect the local film production industry.

CONSULTATION

15. Inland Revenue has consulted on the proposal as part of the government discussion document, *New Zealand's International Tax Review: a direction for change*, released in December 2006 and three submissions were received. The submitters raised a general

² Note that certain types of receipts, which are currently subject to non-resident film renters' tax, would not be subject to NRWT (being outside the royalty definition). These are receipts from the sale or hire of film containers or other film accessories. However, the value of film containers or other accessories relative to the copyright in the film itself would be immaterial. The transfer pricing rules would prevent non-arm's length values being attributed to such accessories if film rental payments were subject to NRWT.

concern about an increased cost of film rental to New Zealand customers. These costs may include the increased tax burden on New Zealanders because of the existing contract conditions (for example, gross-up clauses) and the increased compliance costs on New Zealand customers to withhold tax for the non-resident film renters. Recently, officials have been in contact with the submitters about the proposed change and they raised no additional points to their submissions.

16. Officials have reviewed the submitters' concerns but consider the policy arguments for replacing the non-resident film renters' tax with NRWT are stronger. The change would simplify the New Zealand income tax rules applying to non-residents and, in particular, the burden of the increased tax will not necessarily be borne by New Zealanders because NRWT would generally be creditable in the home country of the non-resident film renter.

17. Inland Revenue has also consulted with the Treasury.

CONCLUSIONS AND RECOMMENDATIONS

18. The recommended option is to replace the non-resident film renters' tax with NRWT so that NRWT applies to amounts derived by non-residents from renting out films in New Zealand.

IMPLEMENTATION

19. The necessary legislative change will be included in the scheduled September 2011 tax bill, with application to payments made on or after the date of enactment.

20. A small number of non-resident film renters would have a reduced compliance burden as a result of the removal of filing responsibility in New Zealand. Some New Zealand customers, who make payments to non-resident film renters for renting and exhibiting film purposes in New Zealand, would have to deduct and return NRWT from payments made to non-resident film renters. Some may need to register with Inland Revenue for NRWT. Because it involves making deductions from gross payments at a flat rate, NRWT is a relatively simple tax to comply with.

21. Inland Revenue intends to identify these New Zealand customers and target them with communications advising them of their new obligations, and what they need to do.

MONITORING, EVALUATION AND REVIEW

22. The new tax treatment of the non-resident film renters would be part of any monitoring, evaluation and review of NRWT. If any specific concerns are raised, officials would determine whether there are substantive grounds for review under the Generic Tax Policy Process. The Income Tax Act 2007 is also subject to regular review by officials.