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

1. 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.
2. 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.
3. 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.
4. 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.
5. 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

1. 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%.
2. 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

1. 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*.
2. 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

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

# Human rights

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

# Legislative implications

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

# Regulatory Impact Analysis

1. 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

1. 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

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

# Publicity

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

# Proactive Release

1. 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