

Hon Stuart Nash, Minister of Revenue

Information Release

Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020

August 2020

Availability

This information release is available on Inland Revenue's Tax Policy website at <https://taxpolicy.ird.govt.nz/publications/2020-ir-cab-leg-20-sub-0087/overview>

Documents in this information release

1. IR2020/262 – Tax policy report: Cabinet paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 (26 May 2020)
2. LEG-20-SUB-0087 – Cabinet paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 (30 June 2020)
3. LEG-20-MIN-0087 – Minute: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 (30 June 2020)

Additional information

The Cabinet paper was considered by the Cabinet Legislation Committee on 30 June 2020 and confirmed by Cabinet on 6 July 2020.

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, 2019–20 Income Year) Order 2020

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: **Cabinet paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020**

Date:	26 May 2020	Priority:	Medium
Security level:	In Confidence	Report number:	IR2020/262

Action sought

	Action sought	Deadline
Minister of Revenue	Agree to recommendations Approve the attached Cabinet paper and advice sheet	25 June 2020

Contact for telephone discussion (if required)

Name	Position	Telephone
Chris Gillion	Policy Lead	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

26 May 2020

Minister of Revenue

Cabinet paper: Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020

Purpose

1. This report informs you about the required annual change to the deemed rate of return on attributing interests in foreign investment funds. A Cabinet paper is attached that recommends an Order in Council be made to set the deemed rate of return for the 2019–20 income year.

Background

2. The Income Tax Act 2007 (the Act) requires the deemed rate of return under the 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 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 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 book 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 2019–20 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) 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 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 2019–20 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 2019–20 income year is 1.05%. This means that the deemed rate of return for the 2019–20 income year will be 5.05% (1.05% plus four percentage points). This is a decrease from last year's deemed rate of return, which was 5.86%.

Regulatory Impact Analysis

10. 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

11. 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.
12. This Order in Council will enable taxpayers using the deemed rate of return method to calculate their FIF income for the 2019–20 income year and therefore needs to apply retrospectively from 1 April 2019.
13. The attached Cabinet paper is drafted so that the Order in Council complies with the 28-day rule for regulations and therefore comes into force on 6 August 2020.
14. However, officials recommend that a waiver of the 28-day rule is sought. Taxpayers that use the deemed rate of return are not able to use the old rate to file a return for the 2019–20 year; they must wait for the new rate to come into force. It is of no benefit to taxpayers or the Government to require some taxpayers to wait an extra 28 days to be able to file a return solely because they are waiting on the rate to come into force.
15. If you 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 25 June 2020, for consideration at the Cabinet Legislation Committee's meeting on Tuesday 30 June 2020.
17. The Parliamentary Counsel Office will provide copies of the finalised Order in Council directly to the Cabinet Office.
18. A media statement will be issued once the Order in Council has been made.

Consultation

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

Proactive release

20. This 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

We recommend that you:

21. **agree** for the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 to have a commencement date of either:

21.1 6 August 2020;

Agreed/Not agreed

OR

21.2 10 July 2020, requiring a waiver of the 28-day rule to be agreed to by Cabinet (officials' recommendation);

Agreed/Not agreed

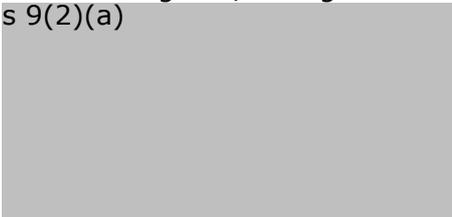
22. **approve** the attached Cabinet paper and advice sheet for consideration at the Cabinet Legislation Committee meeting on Tuesday 30 June 2020;

Approved/Not approved

23. **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

s 9(2)(a)



Chris Gillion

Policy Lead

Policy and Strategy

Hon Stuart Nash

Minister of Revenue

/ /2020

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, 2019–20 INCOME YEAR) ORDER 2020

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 on attributing interests in foreign investment funds at 5.05% for the 2019–20 income year.

Background

2. New Zealand's foreign investment fund (FIF) rules tax New Zealand residents on income from certain foreign investments. There are several methods for calculating the taxpayer's income or loss from these investments, as set out in legislation. 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 from non-ordinary shares with debt-like properties, such as shares that guarantee a return. The method can only be used if the market value of the foreign investment cannot be determined at the end of the income year.
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 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 2019–20 income year is 1.05%. The attached Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 therefore sets the deemed rate of return for the 2019–20 income year at 5.05% (1.05% 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 5.86%.

Timing

8. The new deemed rate of return should come into force as soon as practicable to allow taxpayers using this rate to file their tax returns as soon as they can. I therefore recommend that the new rate comes into force on 10 July 2020.
9. To ensure a commencement date of 10 July 2020, I recommend that the 28-day rule be waived for the coming into force of this Order. This will ensure that taxpayers using the deemed rate of return method for calculating their income are able to promptly file their tax return using the correct rate for the 2019–20 income year.
10. If a waiver is not agreed to, then taxpayers that use the deemed rate of return method will not be able to file a return until the 28-day period has been satisfied. Taxpayers in this situation are unable to use last year's deemed rate of return to file for the 2019–20 income year and must wait for the current year's rate to come into force.
11. It is of no benefit to taxpayers or the Government to require taxpayers using the deemed rate of return to wait an extra 28 days to be able to file their tax return. This would be a source of frustration for taxpayers who want to file their tax returns quickly but are unable to do so. Therefore, I recommend that the 28-day rule be waived.

Consultation

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

Compliance

13. The Order complies with each of the following:
 - 13.1 the principles of the Treaty of Waitangi;
 - 13.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 13.3 the principles and guidelines set out in the Privacy Act 1993;
 - 13.4 relevant international standards and obligations; and
 - 13.5 the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Legislative Implications

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

Impact Analysis

15. 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

16. 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

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

Publicity

18. Once the Order in Council is made, Inland Revenue will publish the new rate on their website.

Proactive Release

19. 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

The Minister of Revenue recommends that the Cabinet Legislation Committee:

1. **note** that the attached Order in Council sets the deemed rate of return on attributing interests in foreign investment funds at 5.05% for the 2019–20 income year;
2. **note** that a waiver of the 28-day rule is sought:
 - 2.1 so that the Order can come into force on 10 July 2020;
 - 2.2 on the grounds that taxpayers using the deemed rate of return method for calculating their income must wait for the 2019–20 rate to come into force, and that it is of no benefit to taxpayers or the Government to require taxpayers using the rate to wait an extra 28 days to be able to file their tax return;
3. **agree** to waive the 28-day rule so that the Order comes into force on 10 July 2020;
4. **authorise** the submission to the Executive Council of the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020.

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, 2019–20 Income Year) Order 2020

Portfolio **Revenue**

On 30 June 2020, the Cabinet Legislation Committee:

- 1 **noted** that the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 sets the deemed rate of return on attributing interests in foreign investment funds at 5.05 per cent for the 2019–20 income year;
- 2 **authorised** the submission to the Executive Council of the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019–20 Income Year) Order 2020 [PCO 22969/2.0];
- 3 **noted** that a waiver of the 28-day rule is sought:
 - 3.1 so that the Order can come into force on 10 July 2020;
 - 3.2 on the grounds that taxpayers using the deemed rate of return method for calculating their income must wait for the 2019–20 rate to come into force, and that it is of no benefit to taxpayers or the Government to require taxpayers using the rate to wait an extra 28 days to be able to file their tax return;
- 4 **agreed** to a waiver of the 28-day rule.

Gerrard Carter
Committee Secretary

Present:

Hon Chris Hipkins (Chair)
Hon Andrew Little
Hon David Parker
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Tracey Martin
Hon Eugenie Sage
Michael Wood MP (Senior Government Whip)

Officials present from:

Office of the Prime Minister
Officials Committee for LEG