

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, 2020–21 INCOME YEAR) ORDER 2021

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 4.43% for the 2020–21 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. 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.
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. 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

5. The average of the quarterly five-year Government bond interest rates for the 2020–21 income year is 0.43%. The attached Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2020–21 Income Year) Order 2021 therefore sets the deemed rate of return for the 2020–21 income year at 4.43% (0.43% 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 5.05%.

Timing

6. 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 18 June 2021.
7. To ensure a commencement date of 18 June 2021, 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 2020–21 income year.
8. 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 2020–21 income year and must wait for the current year's rate to come into force.
9. 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

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

Compliance

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

Legislative Implications

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

Impact Analysis

13. 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

14. 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

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

Publicity

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

Proactive Release

17. 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 4.43% for the 2020–21 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 18 June 2021;
 - 2.2 on the grounds that taxpayers using the deemed rate of return method for calculating their income must wait for the 2020–21 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 18 June 2021;
4. **authorise** the submission to the Executive Council of the Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2020–21 Income Year) Order 2021.

Authorised for lodgement

Hon David Parker
Minister of Revenue