

Regulatory Impact Statement: Thin capitalisation settings for infrastructure investment

Decision sought	<i>Final Cabinet decisions</i>
Agency responsible	<i>Inland Revenue</i>
Proposing Ministers	<i>Minister of Revenue and Minister of Finance</i>
Date finalised	<i>12 March 2026</i>

The proposal addresses issues that arise when New Zealand's thin capitalisation rules may unduly disincentivise foreign investment in infrastructure in New Zealand.

Summary: Problem definition and options

What is the policy problem?

Foreign investors can choose to fund their New Zealand investment with either equity or debt. However, the tax-deductible treatment of interest on debt compared to non-deductible dividends on equity investment provides an incentive for them to invest into New Zealand through debt rather than equity.

The thin capitalisation rules protect the New Zealand tax base by preventing multinational firms from allocating excessive debt to New Zealand to reduce their tax liability. This is done by limiting the amount of deductible debt (debt with tax deductible interest payments) allowable in New Zealand. Generally, some interest expense deductions would be denied if the New Zealand group's debt percentage (that is, the ratio between the debt and the assets' value after subtracting non-debt liabilities) exceeds 60%, or 110% of the multinational group's worldwide debt percentage (whichever is higher).

Although the rules generally work as intended, they may be too rigid particularly for foreign investment in infrastructure. High levels of third-party debt (exceeding 60%) can arise in some infrastructure projects and businesses because they tend to be capital intensive but usually have stable cashflows backed by long-term contracts or service agreements. Under the current rules, some interest deductions may be denied even though the levels of debt may not be considered excessive in commercial terms. This could raise funding costs and disincentivise such investment.

The rules were relaxed in 2018 to provide an exemption from the thin capitalisation rules for public private partnership (PPP) infrastructure projects. This allowed these projects to take on debt in excess of the limits imposed by the general rules, provided that the debt is third-party debt with limited recourse (it is fully supported by the project with no recourse to the investors). However, this treatment applies only to PPP infrastructure projects with the Crown or a public authority. It does not apply to other infrastructure investments.

What is the policy objective?

The primary aim of the proposal is to deal with tax concerns caused by the current thin capitalisation rules that could unduly discourage foreign investment in New Zealand's infrastructure, while still preserving the integrity of the overall regime.

What policy options have been considered, including any alternatives to regulation?

The following have been considered as policy options:

1. Status quo: A non-PPP infrastructure investment in New Zealand with a single foreign investor holding an ownership interest of more than 50% would generally need to keep the debt level of the investment below 60% of the value of the assets to avoid denial of some interest expense deductions.
2. Rule targeted at new infrastructure projects or upgrades: An entity applying the rule would be allowed to fully deduct its interest expense on all third-party debt that only has recourse to the project, provided the debt financing is applied to fund or refinance an eligible infrastructure project to significantly upgrade or create new assets in New Zealand that are expected to have a life of at least 10 years.
3. Rule targeted at infrastructure investments: The rule would still be targeted at infrastructure but apply more broadly, covering not only new infrastructure projects or upgrades, but also existing infrastructure projects and businesses. Eligible infrastructure entities would be allowed to fully deduct their interest expense on all third-party debt that only has recourse to the entity's New Zealand assets.
4. General rule applying to third-party limited recourse debt: This option would apply on a New Zealand-group level. A group applying the rule would be allowed to fully deduct its interest expense on debt financing applied to fund any business activities in New Zealand, provided that the debt is issued to an unrelated third party and the lenders can only have recourse to the New Zealand assets of the group. This option would cover infrastructure investments, but its scope would extend beyond such investment to cover all sectors.

Ministers' preferred option was option 3. Introducing these changes would require amendments to tax legislation. This analysis was largely restricted to tax policy options because the policy problem exists because of the existing tax settings in legislation.

What consultation has been undertaken?

Inland Revenue undertook a public consultation between 19 May and 19 June 2025 to better understand the concerns associated with the current thin capitalisation settings and whether changing those settings could facilitate increased infrastructure investment in New Zealand. Most submitters indicated that the current rules could unduly deter foreign investment in infrastructure and believed a change would likely foster increased investment. Some stakeholders had examples of when the current rules impacted the project economics and reduced the attractiveness of the investments. One submitter thought the existing rules were already more generous than similar regimes in other jurisdictions.

The issues paper released during the public consultation also sought submissions on options 2 and 4. Option 2 was a more natural extension to the PPP rule and noted as officials' preferred option in the paper. Submitters that supported changes were broadly in favour of option 4 but indicated that option 2 would still be an improvement from the current settings. They also submitted that if option 2 were chosen over option 4, it should apply not only to infrastructure projects or upgrades, but also existing infrastructure assets and businesses.

Officials also held a further targeted consultation from 29 October to 21 November 2025, engaging primarily with the 15 parties that provided submissions on the initial issues paper.

The consultation was limited because of the technical nature of the rules and the expectation that only a small group would be directly impacted due to the nature of the changes. The targeted consultation included a revised proposal (option 3) that incorporated the feedback received from the initial public consultation. Out of the eight submissions received, the majority supported the revised proposal covering both new and existing infrastructure investment in a relatively broad way, although some noted that they would still prefer a more general rule (option 4). One stakeholder continued to maintain that no reform was needed.

Is the preferred option in the Cabinet paper the same as preferred option in the RIS?

Yes. Officials initially preferred option 2, but agreed with submitters' views that, on balance, expanding its application to existing infrastructure businesses (option 3) would result in a better overall outcome, and advised accordingly. The Ministers' preferred option in the Cabinet paper (option 3) aligns with officials' preferred option.

Summary: Ministers' preferred option in the Cabinet paper

Costs (Core information)

Outline the key monetised and non-monetised costs, where those costs fall (e.g. what people or organisations, or environments), and the nature of those impacts (e.g. direct or indirect)

The preferred option would allow eligible infrastructure entities to claim a higher level of interest expense deductions. These provisions, however, would be limited to certain foreign investments in New Zealand's infrastructure that could secure limited recourse third-party debt exceeding 60% of the value of its assets. The fiscal impact is estimated at \$10 million annually, noting that there are uncertainties involved in estimating the potential behavioural impacts from the changes.

Benefits (Core information)

Outline the key monetised and non-monetised benefits, where those benefits fall (e.g. what people or organisations, or environments), and the nature of those impacts (e.g. direct or indirect)

The main benefit of the proposed changes is that it is expected to reduce a tax disincentive to foreign investment in New Zealand's infrastructure assets that arises from the current thin capitalisation settings. Eligible investments could potentially claim higher interest expense deductions, collectively estimated to be \$10 million annually. This could translate to over \$600 million in debt, noting that the value of new investment in New Zealand could be much higher than this figure if the new rule helps encourage investment that would otherwise not take place. The changes would help lower the cost of capital for eligible investments. This should help make infrastructure investment more attractive to foreign investors and could help ease New Zealand's infrastructure deficit.

Any incremental investment in New Zealand's infrastructure assets could be expected to provide public benefits and positive externalities due to their fundamental role in enabling the economy to grow, societies to function, and people to access essential services. It means that there could be some offsetting increase in tax revenue over time due to the increase in economic activities, but this impact has not been costed.

Balance of benefits and costs (Core information)

Does the RIS indicate that the benefits of the Ministers' preferred option are likely to outweigh the costs?

On balance, the benefits of the Ministers' preferred option are expected to outweigh the costs over time. It should help reduce a potential barrier to foreign investment in New Zealand's infrastructure caused by the current thin capitalisation rules. While it is hard to ascertain with any precision how much the changes would lead to increased investment, officials expect the proposed changes would reduce the barrier to foreign investment. This view is widely supported among key stakeholders.

The preferred option is considered to achieve an appropriate balance. It is expected to be sufficiently flexible to address most infrastructure investment scenarios that may be constrained by the current rules, while mitigating the risk of overly broad application. This approach should also limit the fiscal impact compared to the broader solution (option 4).

Implementation

How will the proposal be implemented, who will implement it, and what are the risks?

Legislative amendments to the Income Tax Act 2007 would be made through the Taxation (Annual Rates for 2025–26, Compliance Simplification, and Remedial Measures) Bill. The legislative changes would take effect from 1 April 2026. Inland Revenue would be responsible for the implementation and administration of the new rules. Inland Revenue considers this to be a relatively straightforward change to implement.

Limitations and Constraints on Analysis

The potential changes are not intended as a broad reform of the thin capitalisation regime because the rules generally work as intended. Therefore, options are limited to those addressing the specific issues identified. The options are also limited to those that would largely maintain the integrity of the thin capitalisation regime.

The estimated cost has been calculated using internal data. While the costing considered potential behavioural impacts, there are some uncertainties regarding their magnitude. There is also a possibility that the proposal could introduce some unanticipated opportunities for aggressive tax planning strategies, which could increase the fiscal impacts. This risk can be partially mitigated by limiting the application of the rule to infrastructure.

The practical risks of the policy are further mitigated by the fact that some countries have implemented similar rules.

I have read the Regulatory Impact Statement, and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the preferred option.

s 9(2)(a)

Responsible Manager(s) signature: _____

Sam Rowe

Policy Lead

12 March 2026

Quality Assurance Statement

[Note this isn't included in the four-page limit]

Reviewing Agency: Inland Revenue

QA rating: Meets

Panel Comment: An internal quality assurance panel convened by Inland Revenue has reviewed the Regulatory Impact Statement (RIS) and considers that the information and analysis it contains **meets** the quality assurance criteria for Ministers to make informed decisions on the proposals in this paper.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. Foreign investors can choose to fund their New Zealand investments with either equity or debt. However, interest on a debt is generally a deductible expense for the payer, while dividends, or other equity returns, are usually not deductible for the payer. The favourable tax treatment of debt compared to equity investment provides an incentive for foreign investors to invest into New Zealand through debt rather than equity.
2. The thin capitalisation rules protect the New Zealand tax base by preventing foreign investors from allocating an excessive proportion of their debt (and interest expenses) to their New Zealand investments to reduce the amount of tax paid.
3. While the rules generally work as intended, they may be too rigid for some foreign investments in infrastructure. This is because infrastructure investment tends to be capital intensive, and require significant funding, but have stable cash flows to support large amounts of debt. If the amount of debt exceeds the limit allowed under the current thin capitalisation rules, some interest deductions may be denied, even though the debt level is not considered excessive in commercial terms. The denial of deductions would effectively increase the cost for the investment, thereby making marginal investment uneconomic.

Thin capitalisation settings in New Zealand

4. Many countries are aware of the revenue risk from allowing companies operating in their countries to be over-leveraged and have some form of interest limitation or thin capitalisation rules to address this risk. New Zealand introduced thin capitalisation rules in 1996. The rules generally apply to multinational businesses investing in New Zealand. The test applies on a New Zealand-group level rather than on an entity level. The rules limit the amount of debt for the New Zealand group for which interest deductions are allowed by setting a maximum allowable debt percentage.¹
5. There are two key elements to the rules for inbound investment in New Zealand:
 - *Worldwide group debt test*: For groups controlled by a single foreign investor, the rules generally disallow a portion of the interest expense deductions to the extent the debt percentage of the New Zealand group exceeds 110% of the worldwide group's debt percentage. This is intended to prevent groups from allocating excessive debt to their New Zealand operations in comparison with their worldwide operations.
 - *Safe harbour debt threshold*: The rules include a safe harbour debt threshold of 60% to help with compliance costs. This means that if the debt percentage of the New Zealand group does not exceed 60%, all the interest can be deducted without needing to consider the worldwide group debt test.

¹ The debt percentage of a group is calculated using the formula: $\text{group debt} \div (\text{group assets} - \text{non-debt liabilities})$.

Specific public private partnership rule

6. In 2018, New Zealand introduced a specific exemption for public private partnership (PPP) infrastructure projects allowing such projects to take on more debt than the limits imposed by the general thin capitalisation rules, provided the debt is third-party debt (or like third-party debt) that has recourse only to the assets and income arising from the project (limited recourse debt). This treatment applies only to PPP infrastructure projects with the Crown or a public authority. It does not apply to privately owned infrastructure projects or investment in infrastructure businesses.
7. The introduction of a specific rule for PPP infrastructure projects recognised that the standard thin capitalisation rules that apply generally to inbound investment may not work well for this category of infrastructure investment. The rule recognises that a PPP can be very highly geared commercially (approximately 85% to 90% debt funded). This is because third-party lenders see a PPP as a safe investment due to the secure cashflow characteristics of the project (long-term cashflows provided by the Crown).
8. The PPP rule is also consistent with the recommendation under the Organisation for Economic Co-operation and Development's (OECD's) report on Base Erosion and Profit Shifting (BEPS).² This report noted that countries may wish to provide a tightly targeted exemption from interest limitation rules for third-party limited recourse loans used to fund public benefit infrastructure projects/assets. This is because those loans present little to no risk of tax avoidance.

How is the status quo expected to develop?

9. The thin capitalisation rules can affect infrastructure investment (that do not qualify for the PPP rule) more than they affect other sectors. Some infrastructure investment can secure a higher level of debt than is possible with other business activities because lenders usually view such investment as relatively safe. The debt is often supported by long-term purchase or service agreements, which provide a degree of certainty regarding the borrower's ability to service the debt. The current rules may result in interest expense deductions being denied even though the level of debt is fully supported by the New Zealand operations and not considered excessive in commercial terms. This can result in genuine infrastructure investment being taxed at a higher rate than other investments or businesses.
10. Despite the financial security provided by such agreements, the profit margins for infrastructure businesses are also usually lower compared to those from riskier business activities with less predictable cashflows. Therefore, infrastructure investments are also likely to be more sensitive to small changes in the expected rate of return. Denying some of the interest deductions under the thin capitalisation rules may mean that some investments do not proceed.
11. While the worldwide group debt test can often help in situations when the 60% safe harbour is breached, it may not help some infrastructure investments for several reasons. For example, the foreign investor may have infrastructure projects of differing maturities around the world with more mature projects potentially having lower debt

² [Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report | OECD](#): refer to pages 39 to 41, which include the recommended conditions for an exemption for public benefit infrastructure project/assets.

levels than less mature ones. The foreign investor may also have investments in a range of industries with different capital structures and debt percentages.

12. The thin capitalisation rules apply only to investments controlled by foreign investors and may therefore place some foreign investors at a disadvantage compared to domestic investors (or foreign-owned investments to whom the rules do not apply – as discussed below). This may reduce competition in bids or investment for projects. The rules might also discourage domestic investors because it may be difficult for them to find foreign investors to take over if they later want to exit from the investment.
13. Under the current rules, investors can potentially avoid the denial of interest expense deductions by structuring their investment so there is no majority foreign shareholder. However, this may not be commercially feasible, or an attractive option for some investors because it may make the size of their investment too small relative to the considerable initial effort required to assess its viability, which may be comparable to that associated with larger investments.

What is the policy problem or opportunity?

14. While New Zealand's thin capitalisation rules generally function effectively, there is a risk that the current rules could unintentionally over-tax genuine commercial transactions. Some stakeholders have mentioned cases when the existing rules affected whether certain infrastructure investments were financially viable.
15. An effective thin capitalisation regime should limit the ability of foreign investors to inappropriately lower their New Zealand-sourced income (to reduce the amount of tax paid here) by loading their New Zealand operations with excessive debt. However, the intent is not to limit high levels of borrowing when those debt levels do not serve that purpose. The introduction of the PPP exemption was intended to reflect this principle. Good tax policy in this area should ensure that foreign-controlled businesses operating in New Zealand pay a commercially appropriate amount of tax, without being overly burdened.
16. There is an opportunity to modernise New Zealand's thin capitalisation rules to ensure they do not unduly disincentivise infrastructure investments compared to other business activities. Relaxing the current settings for infrastructure investments would lower barriers for some foreign investors considering making an infrastructure investment in New Zealand, which could help reduce New Zealand's infrastructure shortfall. It could also improve existing foreign-owned infrastructure businesses' access to funds, which could help them maintain or grow their infrastructure investments here. This would also support the Government's broader goal of improving infrastructure to support economic growth.³

What objectives are sought in relation to the policy problem?

17. The primary objective is to address concerns arising from the current thin capitalisation rules that may hinder foreign investment in infrastructure in New Zealand while maintaining the integrity of the underlying tax rules.

³ [Infrastructure for Growth | Ministry of Business, Innovation & Employment](#)

What consultation has been undertaken?

18. An officials' issues paper [Thin capitalisation settings for infrastructure](#) was released for public consultation on 19 May 2025 to gain a better understanding of how the current thin capitalisation rules might be discouraging foreign investors from investing in infrastructure projects in New Zealand, and whether changing those settings would lead to more infrastructure investment in New Zealand. The consultation closed on 19 June 2025 with 15 submissions received.
19. Apart from one submitter who argued that the existing rules are already more generous than those in comparable jurisdictions, most submitters considered that the current rules may be discouraging some infrastructure investments at the margin and supported a change. Some submitters had examples of when New Zealand's thin capitalisation settings impacted the project economics for some infrastructure investment, reducing the attractiveness of such projects. The majority also believed that a change would likely translate to increased investment.
20. The issues paper also sought submissions on two options contemplated for relaxing the current rules, namely:
 - *a rule targeted at new infrastructure projects or significant upgrades* (discussed below as option 2), which could be viewed as an extension of the PPP rule, and
 - *a general rule applying to third-party limited recourse debt* (option 4), which would include infrastructure projects and businesses, but not be limited to them.
21. When the issues paper was released, officials identified the targeted rule (option 2) as the preferred option. Submitters were broadly in favour of a more general rule citing the potential boundary issues in determining whether a project or investment qualifies as eligible infrastructure as their primary concern with the targeted rule proposed in the issues paper. However, they acknowledged that a targeted rule would still help lower barriers to infrastructure investment, particularly if the scope were expanded to also apply to existing infrastructure assets and businesses. They cited the following reasons for expanding the proposed targeted rule:
 - Ongoing investment in existing infrastructure is critical for maintaining and upgrading essential services.
 - Allowing deductions for investments in existing infrastructure projects and businesses could facilitate easier exits for investors, enabling capital to be recycled into new infrastructure projects.
 - The requirement that the debt only has recourse to the infrastructure project it is funding may not be practical for upgrading projects because lenders typically require recourse over the entire asset or asset portfolio, not just the upgrade. Further, it can be unclear what level of enhancement qualifies as "significant" upgrades, adding further complexity.
 - It is important that the tax system does not distort investment decisions. In many cases, upgrading existing infrastructure may be more economical than complete replacement. The rule should not favour one approach over the other.

22. Officials undertook further targeted consultation from 29 October to 21 November 2025. The technical issues paper was shared primarily with those who submitted on the initial issues paper and introduced a revised proposal (option 3) that incorporated the feedback received from stakeholders. Limiting the consultation to selected stakeholders reflected the technical nature of the paper and the expectation that only a small group of stakeholders would be directly affected by the changes, as indicated by the limited number of responses during the earlier public consultation. Officials received eight submissions on the targeted consultation.
23. The revised proposal expanded the targeted rule to apply also to existing infrastructure projects and businesses, including the maintenance and operation of the infrastructure assets in those projects and businesses. It also allowed the acquisition of existing infrastructure projects and businesses. This revised proposal was generally well received by submitters although some indicated that they would still prefer a more general rule (option 4) because it would avoid definitional issues around eligible infrastructure. It would also ensure sector neutrality (although some submitters considered that only infrastructure businesses could usually take on more than 60% of commercial third-party debt). This view stood in contrast to one submitter that thought no reform was needed and noted that the revised proposal had the potential to result in higher interest deductions in New Zealand without a corresponding increase in infrastructure investment in some cases.
24. During the policy project, Inland Revenue also consulted with the Treasury, New Zealand Trade and Enterprise and National Infrastructure Funding and Financing Limited.

Section 2: Assessing options to address the policy problem

What criteria will be used to compare options to the status quo?

25. The options will be evaluated against the traditional tax policy criteria:
 - **Efficiency:** To the extent possible, taxes should be efficient and minimise any negative impact to economic growth and distortions in economic behaviour. That is, the tax system should avoid unnecessarily distorting the use of resources (for example, causing biases toward one form of investment relative to another).
 - **Revenue integrity:** The tax system should be sustainable over time and minimise opportunities for tax avoidance and arbitrage.
 - **Equity:** The tax system should promote fairness. Taxpayers who are in a similar position to one another should receive equal tax treatment.
 - **Coherence:** Individual reform options should make sense in the context of the entire tax system. While a particular measure may seem sensible when viewed in isolation, the measure may not be desirable given the tax system as a whole.
 - **Fiscal impact:** Tax reforms need to be affordable given fiscal constraints and ensure that the tax base is protected.
 - **Compliance and administration costs:** The tax system should be as simple as possible and impose the lowest possible costs on taxpayers to comply with the rules, minimising also the cost for Inland Revenue to administer, without compromising the integrity of the tax system.

26. Efficiency and revenue integrity are the criteria that are most directly linked to the policy objective of removing a potential tax disincentive to foreign investment in infrastructure while maintaining the integrity of the thin capitalisation regime. Therefore, they will be weighted higher than other criteria in the analysis. These criteria need to be balanced against equity, coherence, and the fiscal cost. Compliance and administration costs inform the design of each option to ensure that the solution is viable.

What scope will options be considered within?

27. This regulatory impact statement examines options to address tax concerns caused by New Zealand's current thin capitalisation rules. Since these rules are part of a regulatory regime, addressing the core problem will require legislative changes. Therefore, only regulatory solutions have been considered. The options were developed through the scope of the problem definition and the objectives, and they will be evaluated based on the criteria outlined above.
28. The potential changes are not intended as a broader reform of the thin capitalisation regime because the rules generally work as intended. Some options, such as increasing the inbound safe harbour threshold from 60%, have not been considered. Although this could help reduce the tax barrier to foreign investment in New Zealand's infrastructure assets, it could also significantly undermine the integrity of the thin capitalisation rules. It would also not be targeted at the policy problem identified, which is the effect of the thin capitalisation rules on infrastructure investment.
29. Maintaining the integrity of the thin capitalisation regime is an important criterion. Therefore, the options under consideration are limited to those permitting a high level of debt only when such financing originates from bona fide third parties. This is because allowing substantial levels of related-party debt could permit investors to substitute equity with debt, thereby reducing their tax liability in New Zealand without materially altering the risk profile for the investor. It could also allow interest deductions to be claimed for uncommercial levels of debt, effectively depleting the New Zealand tax base.
30. In developing the options, officials have also undertaken a high-level review of the interest limitation approaches taken in some countries, particularly in respect of infrastructure investment. Care is taken in comparing New Zealand's rule with the rules in other countries because of the difference in the interest limitation tax rules and the difference in overall tax settings:
- Some countries, including Canada, Ireland, the United Kingdom, and the United States, supplement their general interest limitation rules with a specific exemption that applies to infrastructure investment with the scope of the exemption varying. The analysis helps inform the designs of options 2 and 3 discussed below.
 - Australia has taken a different approach by recently including a sector-agnostic "third-party debt test" as part of its interest limitation rules. Features of this rule inform the design of option 4 discussed below.

What options are being considered?

Option 1 – Status quo

31. Section 1 described the issues created by the status quo. The issues primarily impact foreign investors who have more than 50% ownership interest in non-PPP infrastructure investments in New Zealand. If the investments are funded by debt above 60% of the value of the assets, some interest expense deductions may be denied, even if the debt is third-party limited recourse debt (which indicates that the debt level is fully supported by the New Zealand operations). The denial would effectively increase the cost for the investment and might mean that some investments do not proceed.

Option 2 – Rule targeted at new infrastructure projects or significant upgrades

32. This option would involve introducing an exemption, similar to the PPP rule, to non-PPP infrastructure projects. An entity applying the rule would be allowed to fully deduct interest when the following requirements are met:

- The debt funding is applied by the entity to fund (or refinance) a project aimed at creating new or significantly upgrading eligible infrastructure assets in New Zealand that are expected to have a life of at least 10 years.
- The debt is from an unrelated third party and has recourse only to the project (to ensure the debt is at a commercially reasonable level for the project).
- The interest expense, infrastructure project assets, and the income arising from the project assets all arise or are incurred in New Zealand.

33. Eligible infrastructure assets would include core infrastructure that provides, or is integral to providing, essential services to the public or a class of users on a shared-use basis, such as:

- transport infrastructure (for example, roads, rail, ports, airports, and ferries)
- energy infrastructure (for example, electricity generation, transmission, and distribution assets)
- water infrastructure (for example, water supply, wastewater and stormwater systems)
- telecommunication infrastructure (for example, fibre networks, data centres, and communications towers)
- waste infrastructure (for example, recycling facilities and landfills), and
- social infrastructure (for example, hospitals, schools, prisons, large-scale student accommodation or similar public facilities).

34. If an entity uses this rule, any interest expense on debt that does not qualify (such as related-party loans from investor) would not be deductible.

Option 3 – Rule targeted at infrastructure investments

35. This option would involve introducing a rule that would still be targeted at infrastructure but apply more broadly, not only to new infrastructure projects and upgrades, but also to existing infrastructure projects and businesses.

36. The rule would allow an entity that would otherwise breach the general thin capitalisation thresholds to fully deduct interest on debt when the following key requirements are met:

- The debt funding is provided to an eligible infrastructure investment in New Zealand.

- The debt must be from a bona fide third party and have recourse only to the eligible infrastructure investment.
- The debt must not have any equity-like characteristics or features.

37. Eligible infrastructure investment would include new and existing projects, and businesses whose main activity is creating, operating, maintaining, or upgrading qualifying infrastructure assets that they own. The definition of qualifying infrastructure assets would be the same as for option 2, and would include core infrastructure that provides, or is integral to providing, essential services to the public or a class of users on a shared-use basis.

Option 4 – General rule applying to third-party limited recourse debt

38. This option would involve introducing a more general rule that would primarily be limited in application, not by the sector that it would apply to, but by the type of debt arrangement. The rule would apply to infrastructure projects and businesses but not be limited to them. Such a rule would share some similarities to the third-party debt test that has been introduced in Australia recently.

39. The rule would apply on a New Zealand group level rather than on an entity or project level. A group applying the rule would be allowed full interest expense deductibility when the following requirements are met:

- The debt is issued to an unrelated third party.
- The lenders can have recourse only to the New Zealand assets of the borrowing entity or its New Zealand group.
- The debt funding is fully used to fund commercial or business activities in connection with New Zealand.
- The borrower is a New Zealand resident entity.

40. For a group that chooses to apply the new test, the interest expense would be non-deductible on debt that does not fulfil the above requirements, such as related-party debt, debt that provides recourse to overseas assets, debt guaranteed by a foreign parent, or debt when the funding is applied directly or indirectly to support commercial activities overseas.

How do the options compare to the status quo/counterfactual?

	Option 1 – Status Quo	Option 2 – Rule targeted at new infrastructure projects or significant upgrades	Option 3 – Rule targeted at infrastructure investments (preferred)	Option 4 - General rule applying to third-party limited recourse debt
Efficiency	0	+ Reduces tax impediment only for new infrastructure projects or upgrades	++ Reduces tax impediment for infrastructure investment	++ Reduces tax impediment for foreign investment in all sectors
Revenue integrity	0	0 Unlikely to create opportunity for	0 Unlikely to create opportunity for	- Might create some opportunities for

		aggressive tax planning	aggressive tax planning	aggressive tax planning
Equity	0	0 Full interest expense deductibility is still only available to a limited group of taxpayers	+	++ Avoids favouring a particular sector
Coherence	0	0 Maintains the integrity of the thin capitalisation rules	0	- Might compromise the integrity of the thin capitalisation rules
Fiscal impact	0	- Estimated to be less than \$10 million per annum in the long run (potentially no impact in the short term)	-	-- Estimated to be \$20 million per annum with significant revenue risk
Compliance and administration costs	0	- Some additional costs for taxpayers to ensure compliance with the requirements	-	- Some additional costs for taxpayers to ensure compliance with the requirements
Overall assessment	0	+	++	+
		Efficiency and revenue integrity are weighted higher than other criteria	Efficiency and revenue integrity are weighted higher than other criteria	Efficiency and revenue integrity are weighted higher than other criteria

Key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
--	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

41. The status quo (option 1) will not achieve the policy objective because the existing policy settings would likely continue to disincentivise some foreign investment in New Zealand's infrastructure assets by potentially over-taxing genuine commercial transactions.
42. On balance, an expanded targeted rule that applies to all eligible infrastructure investment (option 3) is the option that is likely to best address the problem, meet the

policy objectives, and deliver the highest net benefits. This approach recognises that the thin capitalisation rules can affect infrastructure investment more than other sectors.

43. This option should be sufficiently versatile to accommodate a wide variety of infrastructure investment and financing arrangements. Therefore, it is expected to adequately address most of the cases identified in which the existing thin capitalisation rules may unduly discourage foreign investment, while also limiting the risk of the rule being applied too broadly and providing opportunities for aggressive tax planning and tax avoidance. Requiring debt to be issued to genuine third-party lenders with recourse only to infrastructure assets in New Zealand should ensure the rules apply only to commercially reasonable levels of debt and limit investors' ability to over-allocate interest costs to the New Zealand operation.
44. Option 3 acknowledges that ongoing investment in the operation and maintenance of infrastructure assets is just as important as building new assets or making significant upgrades. It also avoids distorting investment decisions by favouring one form of investment over another. For example, if a rule applied only to new assets or upgrades, companies might unnecessarily replace old assets with new ones even though, without tax considerations, sticking with the current asset would be more cost-effective.
45. This approach would also support asset recycling. For instance, once an infrastructure project is complete and operational, an investor might want to sell their stake. By doing so, they can free up capital to invest in developing a new infrastructure asset. The rule also helps to ensure that there is a commercial market for an infrastructure project or business sales where debt can be used to help finance the acquisition provided it is from unrelated third parties. This is important for infrastructure investors who may wish to exit the investment in the medium term (rather than holding to the end of the infrastructure's useful life).
46. Option 2 was initially proposed as officials' preferred solution during the initial public consultation because it was a more natural extension to the PPP rule. The rule would be more tightly targeted at addressing the issue of how the current thin capitalisation rules might be discouraging new infrastructure projects or upgrades when there is usually a genuine need to raise additional capital through debt financing. However, it would not fully address the issues, particularly for some infrastructure investments, such as:
 - A business might commercially need to raise additional debt financing via debt facilities secured against the overall business. Under option 2, the debt would not qualify even if the financing was used to fund the ongoing business or an upgrade of infrastructure assets.
 - Requiring the debt financing to only have recourse to the project may not be practical for some upgrading projects because lenders typically require recourse over the entire asset or asset portfolio, not just the upgrade.
47. The more general rule (option 4) could be seen as a more principled approach based on the premise that if the income generated by the New Zealand operations alone can support the borrowing, the level of debt should not be considered excessive. This option would avoid the boundary issues associated with determining what constitutes an eligible infrastructure. It would also avoid potentially favouring a particular sector.

48. Officials have some reservations about this approach because it could pose integrity risks for the thin capitalisation regime overall due to its broad application across all sectors. The purpose of the thin capitalisation rules when first introduced was wider than just preventing deductions for uncommercial levels of debt. The purpose was to prevent excessive debt (including third-party debt) from being allocated to a group's New Zealand operations compared with its worldwide operations. So, for example, the rules were intended to prevent a group from incurring most of the borrowing for its worldwide operations in New Zealand (and so claiming most of its interest deductions against New Zealand's tax base) even when that borrowing was from third parties on commercial terms. The more general rule would potentially allow businesses to over-allocate their worldwide debt to New Zealand in some circumstances.

49. On the other hand, infrastructure is an investment class that is more likely to be unduly impacted by the general thin capitalisation rules. Limiting debt to third parties that only have recourse to New Zealand infrastructure assets reduces the risk of the rule having unintended consequences. Going broader would increase the potential for aggressive tax planning and unanticipated scenarios, which could significantly raise fiscal costs.

Is the Ministers' preferred option in the Cabinet paper the same as the agency's preferred option in the RIS?

50. Yes, the Ministers' preferred option aligns with the option recommended by officials (option 3).

What are the marginal costs and benefits of the preferred option in the Cabinet paper?

Affected groups <i>(identify)</i>	Comment <i>nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.</i>	Impact <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.</i>	Evidence certainty <i>High, medium, or low, and explain reasoning in comment column.</i>
Additional costs of the preferred option compared to taking no action			
Foreign investors with more than 50% ownership interest in non-PPP infrastructure investments in New Zealand that are funded by debt above 60% of asset value and the debt is third-party limited recourse debt	There might be additional costs to taxpayers opting to apply the rule to ensure compliance	Low – the incremental effort over the existing requirements should not be significant	Medium
Inland Revenue	The changes would be delivered using a process similar to the current rules	Low	High

Crown	Reduction in tax revenue due to higher interest expense deduction claims	Estimated to be \$10 million per annum	Low – there are uncertainties involved in estimating the potential behavioural impacts
Total monetised costs		Estimated to be \$10 million per annum	Low
Non-monetised costs		Low	Medium
Additional benefits of the preferred option compared to taking no action			
Foreign investors with more than 50% ownership interest in non-PPP infrastructure investments in New Zealand that are funded by debt above 60% of asset value and the debt is third-party limited recourse debt	The changes would reduce the cost of capital by removing potential over-taxation under the current rules	Collectively estimated to be \$10 million per annum	Low – there are uncertainties involved in estimating the potential behavioural impacts
New Zealand public and companies	The changes could lead to more infrastructure investment and better and/or cheaper infrastructure	Low	Low – hard to ascertain with any precision how much the changes will lead to increased foreign investment in infrastructure, but officials expect the changes would reduce the current barrier
Total monetised benefits		Estimated to be \$10 million per annum	Low
Non-monetised benefits		Low	Low

51. The estimated cost was calculated based on available internal data. While the costing accounts for potential behavioural changes, assessing these with any precision remains difficult. Additionally, there is a possibility that the proposed rule could introduce opportunities for aggressive tax planning strategies that were not anticipated, potentially increasing fiscal impacts. However, limiting the application of the rule to infrastructure should reduce such risk.

52. The preferred option focuses on infrastructure, which tends to deliver more public benefits and positive externalities than other sectors or types of assets. Infrastructure is essential because it supports economic growth, enables societies to function, and helps people access vital services such as healthcare, education, and employment. It acts as the foundation for everyday life, business activity, and general wellbeing, and could help drive higher levels of economic growth. However, this impact has not been included in the costing due to the difficulties in making reliable estimates.

Section 3: Delivering an option

How will the proposal be implemented?

53. The proposed changes require amendments to the Income Tax Act 2007, which would be made through the Taxation (Annual Rates for 2025–26, Compliance Simplification, and Remedial Measures) Bill. The legislative changes would take effect from 1 April 2026.
54. Inland Revenue will be responsible for the implementation and administration of the new rules. Inland Revenue will issue guidance on its website to support understanding of the new rules and taxpayer compliance.
55. The proposed changes will not require any significant systems changes.

How will the proposal be monitored, evaluated, and reviewed?

56. Policy officials would maintain communication channels with both internal and external stakeholders. If issues emerge, they will be dealt with operationally, or by way of legislative amendment if agreed by Parliament.