



30 May 2008

Stapled Stock Consultation  
C/- Deputy Commissioner  
Policy Advice Division  
Inland Revenue Department  
PO Box 2198  
Wellington

Dear Sir

**Draft legislation for stapled stock amendments to Income Tax Act 2007**

The Investment Savings and Insurance Association ("ISI") appreciates that opportunity to comment on the draft legislation for stapled stock amendments to the Income Tax Act 2007, released on 23 April 2008.

ISI represents the issuers and managers of life insurance, superannuation and managed funds. Our members will be affected by the amendments as issuers of funds that are widely-held New Zealand companies, providing the opportunity for investment into New Zealand assets by both local and offshore investors.

While we are pleased to have the opportunity to comment on the draft legislation we do not support its introduction in its current form.

There is significant concern within our members regarding the potential impact of the legislation on investment into New Zealand funds as well as concern over some uncertainty in interpretation and specific technical difficulties which are covered in more detail below.

We are also very concerned at the manner of introduction of this change and its announcement by media release.

**We recommend:**

- that an interest deduction for stapled debt instruments is allowed where certain conditions are met; and

- that for outbound investment the combined debt and equity returns should be subject to the FDR regime, but limited to widely held investment vehicles

## **KEY CONCERNS**

### **Inbound**

The proposed changes will affect the way that international investors invest into New Zealand. The draft legislation sends the wrong message to those investors and it is likely to push them into 100% ownership of assets rather than co-investment with NZ investors via a simple stapled structure that would attract still attract tax in NZ to the extent that the investment is equity funded.

We are concerned that the proposed legislation will create uncertainty in interpretation, with a consequential increase in compliance costs and investors choosing to invest in Australia rather than NZ (especially with the recent Australian budget announcements reducing the tax rate for international investors to 7.5%). There is also uncertainty around what will be considered a new issue and what may be considered a stapled security that was issued before the announcement, eg the status of a unit trust that was established but issues additional units after the announcement date.

Other points of uncertainty are:

- treatment of a stapled debt instrument which becomes unstapled after 25 February 2008;
- whether a part repayment of loan will be treated as a deemed dividend or return of capital;
- will the definition of 'debt security', specifically the use of the words 'or ordinarily can', catch the situation where debt and equity are not formally traded together, but without a shareholder also holding debt the value of the shares would lose their value?
- Inland Revenue audit activity will challenge debt arrangements not specifically stapled, but due to commercial reality debt would be repaid in equal portions or fully when an investor leaves.

The thin capitalisation rules currently provide a mechanism to ensure that returns from investment into New Zealand are taxed appropriately. Concern about the effectiveness of the rules should be addressed by attention to the debt/equity ratio (75/25) rather than by the proposed legislative change that targets a specific investment instrument. The current thin capital ratio of 75% debt to 25% equity provides adequate protection to the New Zealand tax base while at the same time ensuring participation in New Zealand capital markets by both domestic and international investors.

Our recommendation is that the thin capitalisation rules should determine whether interest deductions are excessive or not and deductions should be available where:

- thin capitalisation rules are met (i.e. debt/equity threshold does not exceed 75% debt), regardless of the size of any offshore ownership; and
- market rate of interest is used (at time rate is set); and
- on maturity, debt is repaid at face value (i.e. fixed dollar amount -or converted to shares based on price at time of conversion).

### **Outbound**

In addition, it is not clear whether the new rules will apply to stapled securities issued by offshore companies. In the event that they do, our recommendation is that the combined debt

and equity returns of a stapled security should be covered by the FDR regime. That would provide a fair reflection of the economic position and also limit significant compliance costs that would occur in having to identify, track and tax two separate instruments.

We are happy for officials from Inland Revenue and Treasury to contact us, if necessary, to discuss this submission. The contact phone number is (04) 473 8730.

Yours faithfully

Vance Arkinstall  
**CHIEF EXECUTIVE**