Inland Revenue
Te Tari Taake

26OIA1806

2 February 2026

[redacted]

Dear [redacted]

Thank you for your request made under the Official Information Act 1982 (OIA), received on 30 December 2025. You requested the following:

1. *Submissions made by certain law firms (i.e. Russell McVeagh, Bell Gully, Chapman Tripp, Simpson Grierson, MinterEllisonRuddWatts, Buddle Findlay and Mayne Wetherell) on the Issues Paper issued 19 May 2025: Thin capitalisation settings for infrastructure*
2. *Submissions made by certain law firms (i.e. Russell McVeagh, Bell Gully, Chapman Tripp, Simpson Grierson, MinterEllisonRuddWatts and Buddle Findlay) on the Issues Paper issued January 2013: Review of the Thin Capitalisation Rules*

Information being released

I have identified 3 documents in scope of your request, attached as **Appendix A**.

Some information in the documents is withheld under section 9(2)(a) of the OIA, to protect the privacy of natural persons, including that of deceased natural persons.

Item	Date	Document
1.	18 February 2013	Russell McVeagh submission on Issues Paper: Review of the thin capitalisation rules
2.	19 June 2025	Mayne Wetherell submission on Officials' Issues Paper: Thin capitalisation setting for infrastructure
3.	23 June 2025	Russell McVeagh submission: Thin capitalisation settings for infrastructure

As required by section 9(1) of the OIA, I have considered whether the grounds for withholding the information requested is outweighed by the public interest. In this instance, I do not consider that to be the case.

Right of review

If you disagree with my decision on your OIA request, you have the right to ask the Ombudsman to investigate and review my decision under section 28(3) of the OIA. You can contact the office of the Ombudsman by email at: info@ombudsman.parliament.nz.

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Publishing of OIA response

We intend to publish our response to your request on Inland Revenue's website (ird.govt.nz) as this information may be of interest to other members of the public. This letter, with your personal details removed, may be published in its entirety. Publishing responses increases the availability of information to the public and is consistent with the OIA's purpose of enabling more effective participation in the making and administration of laws and policies and promoting the accountability of officials.

Thank you again for your request.

Yours sincerely

Sam Rowe
Policy Lead - International

RUSSELL McVEAGH

18 February 2013

Review of the thin capitalisation rules
C/- Deputy Commissioner, Policy
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SUBMISSION ON ISSUES PAPER: REVIEW OF THE THIN CAPITALISATION RULES

Introduction

1. This letter sets out Russell McVeagh's submissions on the Officials' Issues Paper entitled "Review of the thin capitalisation rules" ("**Issues Paper**"). We would be happy to discuss this submission with you and be involved in any future consultation on the proposals.

Summary of submissions

2. In summary, our submissions are as follows:

Submissions relating to proposals 1 (Single non-resident requirement) and 3 (Trusts as main shareholder (non-resident with effective control))

(a) Definition of acting together: A question as significant as whether or not the thin capitalisation regime applies to a group of companies should not turn on such an uncertain standard as whether or not two or more shareholders are "acting together" without there being a specific and exhaustive legislative definition of "acting together" or (as a minimum) some precise statutory criteria for ascertaining when they are acting together. An alternative test might be to (similarly to the test of control under the CFC rules) include resident companies owned to the extent of 50% or more by 5 or fewer non-residents.

(b) Adverse consequences for securitisation: The extension of the thin capitalisation rules to a broader range of trusts could bring within the rules special purpose vehicles used in securitisation structures. While the on-lending concession may in some cases apply to (in effect) exclude such SPVs from the scope of the thin capitalisation rules, that will not always be the case. There should be an exception to the thin capitalisation rules, or a modification to the rules for calculating the debt-to-assets ratio, to address this overreach.

(c) Adverse consequences for public-private partnerships ("**PPPs**"): The extension of the thin capitalisation rules to include non-residents "acting together" would exacerbate the overreach of the rules in the PPP context. The thin capitalisation rules will in effect assume that a debt to

asset percentage of greater than 60% is excessive (with the consequence that the deductibility of funding costs may be denied) even though for many infrastructure investments, higher levels of debt-funding are appropriate. There should be an exception to the thin capitalisation rules, or a modification to the rules for calculating the debt-to-assets ratio, to address this overreach.

(d) A test based solely on the debt-to-assets ratio is too rigid: Relying solely on a debt-to-assets ratio in order to determine the appropriate level of debt financing for a multinational's New Zealand operations is too rigid a test. If the application of the thin capitalisation rules are to be broadened as proposed, there should be an alternative test available based on what an arm's length level of debt would be for the New Zealand operations.

Submissions relating to proposal 4 (Capitalised interest)

(e) Capitalised interest should not be deducted from asset values: Capitalised interest expenses should not be deducted from asset values for thin capitalisation purposes. Differences between the tax and accounting treatment of assets and expenditure are inevitable. To require an adjustment in cases in which (due to timing differences in expense recognition) assets for accounting purposes have a greater value than assets for tax purposes does seem selective, given no adjustment would be made in cases in which due to such timing differences, assets for accounting purposes have a lesser value than assets for tax purposes.

(f) If capitalised interest is deducted from asset values, should be clear that only deducted to the extent it increases asset values: If (contrary to our submission above) capitalised interest is to be deducted from asset values, it should be made clear that this deduction is required only to the extent that the capitalisation of interest has resulted in an increase in the value of the relevant asset, and not where (for example) it has been superseded by a revaluation.

Submission relating to proposal 6 (Asset "uplift")

(g) The proposed exception for sales of an entire group to a non-associate should be broadened: The exception to the proposed asset uplift rule for sales forming part of a sale of an entire group to a previously non-associated party should be extended to include certain sales to associated parties, such as a sale to a company in which a non-associated party holds a non-portfolio voting interest.

Submissions relating to proposals 1 (Single non-resident requirement) and 3 (Trusts as main shareholder (non-resident with effective control))

Definition of "acting together"

3. For a question as important as whether or not the thin capitalisation regime applies, there needs to be a specific and exhaustive legislative definition of "acting together", or at least criteria for determining when parties are or are not "acting together". Based on the current proposals, it is clear that private equity investment by a consortium of investors bound by a shareholder agreement or managed by a single manager is intended to be caught. And at the other end of the spectrum, it is clear that an entity that is listed on a stock exchange and

not owned to the extent of 50% or more by a single non-resident is not intended to be caught. But for other ownership structures, where the New Zealand entity is not listed, but where the shareholders can act relatively independently of each other, it is not clear from the current proposals what will amount to "acting together".

4. We suggest the definition might state that two or more non-residents will not be "acting together" unless they are:

   (a) explicitly co-operating through a written shareholder agreement under which there are provisions requiring the shareholders to contribute debt or to provide a guarantee; or

   (b) being effectively co-ordinated by a person or group of persons, such as a common manager or managers.

5. An alternative test, which would create less uncertainty than the concept of "acting together", might be to (similarly to the test of control under the CFC rules) include resident companies owned to the extent of 50% or more by 5 or fewer non-residents.

Adverse consequences for securitisation

6. The extension of the thin capitalisation rules to a broader range of trusts could bring within the rules special purpose vehicles ("**SPVs**") used in securitisation structures. While the on-lending concession may in some cases apply to (in effect) exclude such SPVs from the scope of the thin capitalisation rules, that will not always be the case. The on-lending concession would not provide relief in situations where the securitised assets are of a financial nature but not technically financial arrangements (for example, leases of land, or certain leases of personal property).

7. Further, even where the securitised assets are financial arrangements which provide funds, the on lending concession may not provide full relief to the extent that the value of the debt on issue by the SPV exceeds the value of the assets held by the SPV which "provide funds" to third parties. For example, suppose the value of the debt on issue by the SPV was $100, but (owing to say a rise in interest rates) the value of the (fixed interest) receivables held by the SPV had fallen to $95. The SPV's interest rate swap would have a value of $5; however the SPV does not "provide funds" under an interest rate swap, meaning that it would not qualify for the on-lending concession. Assuming the SPV is the sole member of the New Zealand group with material debt or assets, after taking into account the on lending concession, the New Zealand group would have debt of $5 ($100 of debt, less $95 concession) and assets of $5 (ie, the value of the swap), and so would have a debt-to-assets ratio of 100% (significantly higher than the 60% safe harbour threshold).

8. In Australia, special rules apply to special purpose vehicles used in securitisations, intended to reflect the fact that "securitisation vehicles are tax neutral entities established to pool assets and are generally funded entirely through the issue of debt interests without the need to hold equity".[1] In particular:

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[1] Revised Explanatory Memorandum to the Taxation Laws Amendment Bill (No 5) 2003 at paragraph 1.5.

(a) the method for determining the safe harbour debt amount for "securitisation vehicles" (as defined) includes a provision under which a "zero capital amount" (which includes the value of the securitisation vehicle's "securitised assets") is effectively taken out of the calculation, and debt deductions fully allowed in respect of it;

(b) there is an exemption from the thin capitalisation rules such that they do not apply to certain special purpose entities, where:

(i) the entity is one established for the purposes of managing some or all of the economic risk associated with assets, liabilities or investments (whether the entity assumes the risk from another entity or creates the risk itself);

(ii) the total value of debt interests in the entity is at least 50% of the total value of the entity's assets; and

(iii) the entity is an insolvency-remote special purpose entity according to criteria of an internationally recognised rating agency that are applicable to the entity's circumstances.

9. The exemption described in paragraph 8(b) above was (as noted by the Senate Economics Legislation Committee)[2] described by the Australian Securitisation Forum as:[3]

> ... **absolutely critical to the continued viability of the securitisation market in Australia** which facilitates the provision of competitively priced finance to Australian home owners as well as commercial borrowers. Without the specific exemption, many securitisation structures would fail the thin capitalisation test and **the disallowance of interest would cause any rating that the vehicle had to be removed or downgraded and ultimately cause the winding up of the structure in the short term**.
>
> [Emphasis added]

10. Even a relatively small (in percentage terms) denial of interest expenditure could render a securitisation structure ineffective, as such structures depend, for their efficacy, on tax neutrality. Therefore, if the application of New Zealand's thin capitalisation rules is to be broadened as proposed, there should be an exception to the thin capitalisation rules, or a modification to the rules for calculating the debt-to-assets ratio, to address their potential overreach in the securitisation context.

11. If it were decided to address the issue by way of amendment to the calculation rules, one possibility would be to provide for a group to elect to treat as "total debt" and as on-lending for the purposes of the on-lending concession, financial arrangements that would otherwise not qualify as "total debt" or as on-lending because they do not "provide funds" to the group or to the third party as the case may be. The intended effect of such an election would be that hedging arrangements would count as total debt when they were "out of the money" for the group, and as on-lending when they were "in the money" for the

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[2] The Senate Economics Legislation Committee Report on the Provisions of the Taxation Laws Amendment Bill (No 5) 2003 (August 2003) at paragraph 3.1.

[3] Australian Securitisation Forum submission to the Senate Economics Legislation Committee on the Taxation Laws Amendment Bill (No 5) 2003 (22 July 2003) at page 2.

group. In the context of the example at paragraph 7 above, the consequence would be the $5 balance of the interest rate swap could in effect be bundled with the receivables, so that total debt would be zero.

Adverse consequences for PPPs

12. The extension of the thin capitalisation rules to include non-residents "acting together" would have adverse consequences in the PPP context. The thin capitalisation rules will in effect assume that a debt to asset percentage of greater than 60% is excessive (with the consequence that the deductibility of funding costs may be denied) even though for many infrastructure investments, higher levels of debt-funding are appropriate. Moreover, to subject a SPV established to facilitate PPP financing to the same thin capitalisation framework as applies to an active business misses the point that the SPV is a financing vehicle (in some respects like a SPV in a securitisation structure) and not a stand-alone business that could be expected to have its own capital structure.

13. This issue is a feature of the current rules, but will be exacerbated if the proposed changes proceed. It will create an obvious competitiveness issue, in that bids which do not include a majority of New Zealand investors will be disadvantaged as compared to those that do. This would not only discourage foreign investment into New Zealand PPPs. It could also discourage New Zealand investment, as it might prevent a New Zealand investor from being able to sell to a foreigner if it wished to exit (and so prevent the New Zealand investor from entering in the first place).

14. There should be an exception to the thin capitalisation rules, or a modification to the rules for calculating the debt-to-assets ratio, to address this overreach.

A test based solely on the debt-to-assets ratio is too rigid

15. Relying solely on a debt-to-assets ratio for the New Zealand operations (whether absolute, or relative to that of the worldwide group) in order to determine an appropriate level of debt financing is too rigid and crude a test. Commercially, we understand that the appropriate level of debt is often driven by the relevant group's earnings before interest, tax, depreciation and amortisation (EBITDA) rather than the accounting value of its assets.

16. In Australia, in addition to a safe harbour test based on a debt-to-assets ratio, there is an alternative arm's length debt amount test. Under this test, the maximum allowable debt of a taxpayer is equal to the amount of debt that the Australian operations of the relevant group could be reasonably expected to have obtained from an independent commercial lender on an arm's length basis if the Australian operations of the group were assessed independently from its non-Australian operations. Such arm's length principles are also applied in the United Kingdom (although in the United Kingdom they form the sole test - ie, there are no "safe harbour" levels of debt).

17. If the application of New Zealand's thin capitalisation rules is to be broadened as proposed, there should be an alternative test available based on what an arm's length level of debt would be for the New Zealand operations.

Submissions relating to proposal 4 (Capitalised interest)

Capitalised interest should not be deducted from asset values

18. Capitalised interest expenses should not be deducted from asset values for thin capitalisation purposes. Differences between tax and accounting treatments of assets and expenditure are inevitable and to make a special rule for capitalised interest is arbitrary and unprincipled. The proposal to target capitalised interest in particular therefore focuses on a difference between tax and accounting treatments which is currently favourable to taxpayers without making any changes to inconsistencies which are currently unfavourable to taxpayers.

19. Any attempt to align the deductibility of expenditure for tax purposes with the valuation of assets for thin capitalisation purposes would need to be comprehensive in order to be fair. However, as differences between the accounting and tax treatment of expenditure and assets are common, this would be very difficult to achieve in practice. We submit instead that the proposal to deduct capitalised interest expenses from asset values should not proceed.

If capitalised interest is deducted from asset values, should be clear that only deducted to the extent it increases asset values

20. If (contrary to our submission above) capitalised interest is to be deducted from asset values, it should be made clear that this deduction is required only to the extent that the capitalisation of interest has resulted in an increase in the value of the relevant asset, and not where (for example) it has been superseded by a revaluation.

21. For example, suppose A and B each buy an asset for $100 in year 1. A then capitalises interest of $4 in year 1, such that the carrying value in its accounts is $104. B does not capitalise any interest, and so has a carrying value of $100. If capitalised interest was deducted for thin capitalisation purposes, the value of the asset for A would be reduced by $4 to $100. So far this is consistent with the intention of the proposed reform - that is, A and B would both recognise the same asset value for thin capitalisation purposes. However, if in year 2 an independent valuation determines the asset is worth $110 for both A and B, the carrying value will become $110 for each for accounting purposes. We submit that in these circumstances, A should not be required to deduct the $4 capitalised interest from the asset value (giving an asset value of $106) in year 2, as to do so would mean the asset value for A would be $106 whereas the asset value for B would be $110, which is inconsistent. The capitalisation of interest, while still part of the asset value for accounting purposes, has in effect been superseded by the revaluation.

Submission relating to proposal 6 (Asset "uplift")

22. The exception to the proposed asset uplift rule for sales forming part of a sale of an entire group to a previously non-associated party should be extended to include certain sales to associated parties, such as a sale to a company in which a non-associated party holds a non-portfolio voting interest. In such a case, it can be expected that an asset will be sold at a fair value, as an inflated purchase price would be to the detriment of the non-associated party.

Further consultation

23. We would be happy to discuss this submission with you and be involved in any future consultation on the proposals.

Yours faithfully
RUSSELL McVEAGH

s 9(2)(a)

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Document 2

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19 June 2025

By email
Deputy Commissioner, Policy
Inland Revenue
Wellington

Mayne Wetherell submission on Officials' Issues Paper: Thin capitalisation settings for infrastructure

1. Summary

1.1 This letter sets out Mayne Wetherell's submission on the officials' issues paper – Thin capitalisation settings for infrastructure (**Issues Paper**). We would be pleased to discuss this submission with you if that would be helpful.

1.2 We have not included responses to each of the 37 questions listed in the Issues Paper. Our submission instead addresses two broad issues: the need for reform, and the relative merits of the two possible options for reform discussed in the Issues Paper.

1.3 In summary we submit that:

First submission: the need for reform

(a) Current thin capitalisation settings may result in some foreign direct investment, particularly in infrastructure assets, being over-taxed, as the Issues Paper acknowledges. This reduces investment in (and increases the cost of) infrastructure, and is also a barrier to achieving broader government goals of increasing foreign direct investment. The Issues Paper proposals are therefore welcome and timely.

Second submission: the first (narrower) option is more complex and less workable in practice, such that the second option (a general rule) should be preferred

(b) While any steps to address the over-taxation of foreign direct investment are positive, the narrower of the two options described in the Issues Paper (a new rule targeted at infrastructure) is unlikely to address the problem definition the Issues Paper identifies because it will be complex and create uncertainty as to what is and what is not eligible infrastructure. In particular, that narrower (targeted) option:

(i) would be available only for debt that is limited recourse to new assets or new work done. This would make the rule unworkable in the case of new investment to upgrade existing assets since it is unlikely to be feasible for lending to be with recourse to the new work done but without recourse to the underlying existing asset on which the work is done; and

(ii) would involve significant uncertainty as to what is and what is not infrastructure as defined, and could create a bias against investment in new categories of infrastructure not within whatever definition of infrastructure is used.

(c) The "general rule" (chapter 6) of the Issues Paper avoids these practical difficulties, potential distortions and uncertainties. And if (as proposed) it is available only for third party borrowings that are limited recourse to New Zealand assets and used for New Zealand business activities, the tax base remains protected against arrangements that allocate disproportionate levels of interest expenditure to New Zealand. Above all, the general rule has the advantage of being relatively simple.

2. First submission: the need for reform

2.1 In its 2022 Long Term Insights Briefing, Inland Revenue concluded that:[1] it is "likely to be the case that New Zealand has [higher] taxes on inbound investment compared with most other OECD countries". There are a number of reasons for that, but one important factor in determining the effective tax rate on foreign investment is the thin capitalisation regime.

2.2 Moreover, if the thin capitalisation rules disallow deductions for interest expenditure on arm's length levels of debt, the outcome is equivalent to an extra tax on foreign investment. If investments in certain assets could support (say) a 70% debt to net asset ratio, non-foreign controlled investors in those assets could borrow up to that level and treat their full interest expense as deductible, whereas a foreign-controlled investor would be disallowed an expense deduction to the extent its borrowings exceeded 60%.

2.3 The consequences of over-taxing foreign controlled investors in this way include:

(a) that such investors will be less inclined to invest in New Zealand infrastructure or will require a higher pre-tax return to compensate them for being over-taxed. Either way, the cost of infrastructure goes up (and less infrastructure will be built); and

(b) that New Zealand's tax settings in relation to investment for which an arm's length level of debt exceeds the 60% safe harbour under the current rules effectively discriminate against foreign investors. This is obviously undesirable at a time when New Zealand is seeking to reduce barriers to foreign investment and signal that New Zealand is open for business.[2]

2.4 Two of the five pillars in the Government's Going for Growth initiative are promoting global trade and investment (including attracting high-quality foreign direct investment into New

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1 Inland Revenue "Tax, foreign investment and productivity – Long-term insights briefing" (August 2022) at paragraph 3.7, available here: https://www.taxpolicy.ird.govt.nz/-/media/project/ir/tp/publications/2022/2022-other-final-ltib/2022-other-final-ltib-pdf.pdf?modified=20240813010937&modified=20240813010937.

2 See for example the Overseas Investment (National Interest Test and Other Matters) Amendment Bill and the Government's announcement regarding the Bill which proposes to reform the Overseas Investment Act 2005 (18 June 2025), available here: https://www.beehive.govt.nz/release/going-growth-more-overseas-investment.

Zealand to grow the economy) and infrastructure for growth.[3] Tax settings that over-tax foreign direct investment in infrastructure are obviously a barrier to furthering these objectives.

2.5 We therefore welcome the Issues Paper and the Government's commitment to reform of the thin capitalisation rules. Our second submission (below) is directed at making the reforms as effective as possible in addressing the problem definition that the Issues Paper has identified.

3. Second submission: narrower option is more complex and less workable in practice, the general rule option should be preferred

Narrower (targeted) option would not address problem definition

3.1 The Issues Paper states the objective of the two possible reform options in these terms:

> 4.1 The options considered in this issues paper are intended to address the issue of how our thin capitalisation settings may impede investment in projects aimed at creating or significantly upgrading privately owned infrastructure assets in New Zealand that do not qualify for the public private partnership exemption. The options do this by removing a potential disincentive for such investment. The options are not intended as a broader reform of the thin capitalisation regime.

3.2 The reference to "significantly upgrading" as well as "creating" privately-owned New Zealand infrastructure is important. Much of New Zealand's infrastructure needs comprise the need for renewal of or upgrades to existing infrastructure rather than new infrastructure.[4]

3.3 The narrower (targeted) option, however, would be available only for debt that is limited recourse to new assets or new work done. This would make the rule unworkable for investment to upgrade existing assets, since it is unlikely to be feasible for lending to be with recourse to the upgrade but without recourse to the existing asset that is being upgraded.[5]

Narrower (targeted) option raises practical difficulties in defining the infrastructure that would qualify for the new targeted rule

3.4 The narrower (targeted) option, because it would apply only to borrowings to invest in infrastructure as defined for the purposes of the new rule, would also create boundary issues in determining what is and what is not infrastructure for that purpose. The Issues Paper (at paragraph 5.17) suggests as one approach a "relatively traditional" definition of infrastructure. A traditional definition of infrastructure, however, could well rule out emerging

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3 Available here: https://www.mbie.govt.nz/business-and-employment/economic-growth/going-for-growth

4 New Zealand Infrastructure Commission. (2024). *Build or maintain? New Zealand's infrastructure asset value, investment, and depreciation, 1990–2022*. Wellington: New Zealand Infrastructure Commission / Te Waihanga, at page 5, available here: https://media.umbraco.io/te-waihanga-30-year-strategy/djkmtwj4/build-or-maintain.pdf.

5 The Issues Paper (at paragraphs 5.33 and 5.34.) acknowledges a similar difficulty of a targeted rule in respect of arrangements that are financed on a portfolio basis (eg, if lending to construct a new wind farm was with recourse to an existing wind farm constructed before the new targeted rule came into force).

categories of infrastructure (such as infrastructure critical to the digital economy, to growing use of artificial intelligence, and the like).

3.5 And whatever definition of "infrastructure" were adopted for the purposes of the narrower (targeted) option, businesses would face uncertainty and compliance costs in applying it. Because the proposed narrower rule would allow borrowings with recourse only to "infrastructure" as defined, businesses investing in some assets clearly within that definition and other assets that might not be, might have to separate different assets into different entities to ensure that they did not lose the benefit of the (targeted) rule by using borrowings to invest in assets that fall outside the infrastructure definition.

Second option (the general rule) is simple and avoids the difficulties of the narrower option

3.6 A general rule avoids such practical difficulties, potential distortions and uncertainties, and is relatively simple compared to the targeted rule. The general rule in a sense allows arm's length financiers (rather than Government officials via a prescriptive definition) to determine the types of investment that should qualify for the new rule, because it is only in cases where arm's length financiers are prepared to lend in excess of 60% against the assets in question that the new rule would be engaged.

3.7 The Issues Paper, in discussing a possible general rule, could be read as suggesting that a general rule would undermine the purpose or integrity of the thin capitalisation rules. For instance, at paragraph 6.12, the Issues Paper states that: "A general rule would move away from the underlying policy framework of the thin capitalisation rules, which is intended to prevent the overallocation of debt to New Zealand, based on the overall worldwide gearing ratio when the safe harbour is breached."

3.8 This statement overlooks the important point that the general rule as proposed would allow deductions on a level of debt that is lent by third parties, with recourse only to New Zealand assets. By definition, that level of debt is not an overallocation; it is an amount that third party financiers are prepared to lend against those assets. Moreover, the worldwide gearing ratio is (in our experience) not generally used in practice because of the compliance burden of calculating it, and in any case it assumes a worldwide group with a relatively uniform risk profile (and therefore borrowing capacity relative to assets) internationally.

3.9 Accordingly, we consider that the second option (the general rule) should be preferred. It is sound in principle, includes criteria that prevent excessive interest expenditure that strips out profits, and avoids the practical difficulties and uncertainties inherent in the narrower option.

Yours faithfully

Mayne Wetherell

s 9(2)(a)

Partner

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Document 3

Russell McVeagh

23 June 2025

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SUBMISSION: THIN CAPITALISATION SETTINGS FOR INFRASTRUCTURE

1. INTRODUCTION

Overview

1.1 This letter contains our submissions on the officials' issues paper issued on 19 May 2025 *Thin capitalisation settings for infrastructure* ("**Issues Paper**").

1.2 We have not included a direct response to every question in the Issues Paper but have provided comments in respect of each chapter in the Issues Paper. We would be happy for officials from Inland Revenue to contact us to discuss any of the points raised in this letter or to seek further elaboration regarding the tax, projects and/or finance law aspects.

1.3 All statutory references are to the Income Tax Act 2007 ("**Act**").

Summary of submission points and recommendations

1.4 In summary, subject to the further comments below, our submissions and recommendations regarding the points in the Issues Paper are:

(a) We support the introduction of a targeted rule applying only to infrastructure projects and providing a specific thin capitalisation concession for such projects. The existing rule for PPPs is limited and should extend to other projects where high gearing can be achieved given the project assets and related income stream. In our view, any such targeted rule should not be restricted in its application to third party debt and should also apply to related party debt advanced by investors (subject to appropriate parameters).

(b) We also support the introduction of a more general rule that is focused on debt advanced for specific business activity in New Zealand. In that

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context, we accept that more rigorous restrictions on related party debt are required. We do, however, consider that more analysis is required in relation to the requirement that the debt is limited recourse to New Zealand assets. We recommend that taxpayers have the ability to selectively apply a new general rule to particular group members as a result.

2. SUBMISSIONS

Chapter 2 – Current thin capitalisation settings

2.1 We consider that the existing PPP rule could be relaxed somewhat to contemplate full recourse debt and related party debt. In particular, debt that has a nexus with a qualifying infrastructure project, but with security that has scope beyond the project does not currently receive the benefit of the specific rule. In addition, genuine project finance that is raised offshore and advanced by investors or shareholders to the project vehicle also does not qualify.

2.2 As noted below, in PPP transactions there will be a sufficient degree of commercial tension to ensure that debt levels are sustainable and that the project is viable. In our view, the current settings risk penalising genuine and commercially viable levels of debt that are not intended to facilitate the tax mischief for which the thin capitalisation rules were enacted. We consider that certain of the parameters currently being considered for infrastructure projects generally or the introduction of a general rule could also be used in the PPP context.

Chapter 3 – Problem definition

2.3 In our view, there is a risk that New Zealand's current thin capitalisation settings discourage foreign investment in infrastructure projects in certain cases. Thin capitalisation settings are unlikely to be the sole determining factor in a foreign investor's decision to invest in New Zealand infrastructure, but New Zealand's current settings do not encourage such investment.

2.4 As is the case with most commercial transactions, tax settings play a significant part in whether an infrastructure project or investment is made in New Zealand. Investors and financiers alike will carefully model expected cash flows and returns which will be materially impacted by the tax treatment. The resulting profitability of a project as modelled will impact investment activity. It should be noted that the margins for PPP and infrastructure projects can be thin which means tax settings take on an even greater significance. In addition, infrastructure investors may assess potential projects across several jurisdictions and unfavourable tax settings could, in certain cases, be a material factor for an investment decision where profitability is affected.

2.5 It is difficult to say with any degree of certainty whether changing the thin capitalisation settings will lead to more infrastructure investment in New Zealand. We are not aware of any New Zealand based infrastructure projects that have

not proceeded due to thin capitalisation considerations, although typically that would be a commercially sensitive decision and so difficult to determine.

2.6 Having said that, the introduction of more concessionary thin capitalisation rules with respect to infrastructure can only assist New Zealand's cause in attracting foreign direct investment in this sector. The general 60% threshold seems somewhat arbitrary in the context of an infrastructure project and risks investments or projects with a commercial level of debt being penalised. There will be sufficient commercial tension if the parameters for qualifying debt are set appropriately and it is important to note that these are not transactions where there is a danger of the tax position in New Zealand being manipulated to shift profit offshore from a tax policy perspective. A high level of debt is an ordinary incidence of infrastructure projects.

Chapter 5 – Rule targeted at infrastructure

<u>New and existing infrastructure</u>

2.7 We consider that it is important that a new thin capitalisation rule for infrastructure applies equally to both new and existing infrastructure projects or investments.

2.8 It is important that there is a liquid market for existing infrastructure which may be affected if the tax settings are less favourable. If a new concession does not apply to existing infrastructure, investors are likely to focus primarily on new infrastructure given the comparative returns and the IRR on investment. There is also a run-on effect for the broader infrastructure market as concessionary rules applying to infrastructure generally will promote more investment in the sector and provide certainty for investors (for example, regarding whether investment to replace part of existing infrastructure will qualify).

2.9 In terms of defining, or putting parameters around, qualifying existing infrastructure, the definitions in the New Zealand Infrastructure Commission / Te Waihanga Act 2019 may be a useful starting point. Section 3 of that Act defines "infrastructure project" to include:

(a) the creation of new infrastructure; and

(b) the maintenance, upgrading, replacement, decommissioning, or removal of existing infrastructure.

2.10 For clarity, we consider that limb (b) could also include the expansion of existing infrastructure or projects designed to increase the capacity of existing infrastructure.

2.11 We submit that the key requirements and features in paragraphs 5.2 and 5.4 of the Issues Paper can be readily adapted to apply to existing infrastructure. The scenarios referred to in the definition of "infrastructure project" above can be included by focusing on the specific project being undertaken (for example, the upgrade or expansion of existing infrastructure).

Eligible infrastructure projects or investment

2.12 At a minimum, the categories of eligible infrastructure projects or investment should include those that are "eligible infrastructure" as defined in section 8 of the Infrastructure Funding and Financing Act 2020:

(a) water services infrastructure;

(b) transport infrastructure;

(c) community infrastructure or community facilities; or

(d) environmental resilience infrastructure.

2.13 However, that definition is targeted at specific types of infrastructure that can be funded by levies contemplated by that Act and we consider that a broader description should be permitted for thin capitalisation purposes.

2.14 We support the adoption of an approach similar to that summarised in paragraph 5.18 of the Issues Paper. We recommend an approach that defines "infrastructure" (including new and existing infrastructure) and then a specified list of industries and/or projects that are eligible for the application of the new thin capitalisation concession.

2.15 In that regard, in relation to the equivalent definitions in Ireland and the UK referred to in the Issues Paper:

(a) As noted above, we favour the use of a specific list similar to the approach adopted in Ireland but by reference to industries and/or projects. We agree with the comment in paragraph 5.22 of the Issues Paper that the use of a list as prescriptive as that used in Ireland seems unnecessary in New Zealand.

(b) We also recommend that some flexibility is retained such that a project could be approved for the purposes of the thin capitalisation infrastructure exception by the Governor-General by an Order in Council.

Third party debt versus related party debt

2.16 In our view, any new rule for infrastructure projects should not be restricted to third party debt and should include related party or investor debt that qualifies according to specified criteria or against a specified threshold. Where the investor debt is analogous to third party debt, there is no principled reason to neutralise resulting interest deductions.

2.17 Related party debt is a common feature of infrastructure project financing. The capital composition of a project, including the level and composition of debt, is a commercial decision and not about shifting otherwise taxable profit out of New Zealand with artificially inflated leverage. Particularly in the case of an SPV, the potential over-allocation of debt to New Zealand is unlikely to occur where other investors and third party lenders are involved and acting in their own interests.

2.18 In addition, a blanket exclusion for related party debt means that any debt raised by investors offshore and pushed down into a structure will not qualify for the thin capitalisation concession. It may be commercially more efficient for the parties to raise debt at investor level and then advance that debt to the project vehicle.

2.19 We therefore submit that any new rule for infrastructure projects should include interest deductions arising in relation to related party debt (at least in part without a blanket exclusion).

2.20 Related party debt could be included on the basis:

(a) the related party debt does not exceed a specified percentage of the total project debt; and/or

(b) the related party debt is advanced on terms such that it is not in lieu of equity capital and is effectively provided on an analogous basis to third party debt.

Portfolio debt

2.21 We consider that the potential targeted rule for infrastructure should extend to portfolio debt when the respective assets or projects within the portfolio would have individually qualified. We have no concerns with that approach other than how a taxpayer would establish to Inland Revenue's satisfaction that an individual asset or project would have qualified. Guidance will be required in this context regarding the division of portfolio debt across different projects.

Ability to elect into targeted rule

2.22 We agree that taxpayers should be able to elect into a targeted rule for infrastructure projects (for example, in relation to a given SPV undertaking a particular project). There should also be an ability to switch or reverse the election.

2.23 If a taxpayer or corporate group is compliant with the thin capitalisation rules, either generally or having regard to a targeted rule for infrastructure projects, we do not consider that the integrity of the thin capitalisation rules will be compromised. We have commented on this principle further below in relation to the proposals for a more general rule.

Chapter 6 – General rule

Support for general rule

2.24 We support the introduction of a more general rule that is not restricted to infrastructure projects and broadly agree with the criteria proposed in paragraph 6.2 of the Issues Paper.

2.25 We agree with the principle expressed in paragraph 6.7 of the Issues Paper that: "regardless of the sector, an amount of debt should not be considered excessive if the debt is extended by third party lenders with limited recourse to the New

Zealand operations and is not used to fund commercial activities in other countries".

2.26 As noted above, we consider the application of a 60% threshold to often be relatively arbitrary in relation to the funding of New Zealand based assets. This is particularly so in obvious examples that do not involve a corporate group excessively gearing New Zealand subsidiaries or allocating a disproportionate amount of group debt to a New Zealand subsidiary. If the general rule is restricted to third party debt used to fund New Zealand based assets or income streams, we consider that the inherent commercial tension and the objectives of a third party financier acting in their own interests will sufficiently uphold the integrity of the thin capitalisation rules.

2.27 There are two aspects of the proposed general rule that we consider require further analysis and we have provided comments on those aspects below.

Requirement to ensure debt relates to New Zealand business

2.28 We understand the rationale behind the requirement that "the debt is fully used to fund commercial / business activities in connection with New Zealand". We do, however, have certain reservations regarding how that would be determined in practice. As a related point, we consider that taxpayers should have the ability to apply the existing safe harbour debt threshold to certain members of a group and to apply the alternative general rule to others. We have commented on this point further below.

2.29 Many large corporate groups will operate a treasury function whereby funds are managed on the basis of a pool. It is therefore unlikely to be possible to state definitively whether a given loan has been used to support New Zealand business operations. This is because the funds that come in are not specifically allocated or referable to funds that go out or to the funding of particular assets. Given that money is fungible, it will often be somewhat artificial to state that particular funding relates to New Zealand business operations.

2.30 Given the above, as a practical matter, a corporate group or investors may elect to use a SPV company to own and manage particular assets in order to more readily illustrate compliance with a new general test. If that is the case, we consider that groups should have the ability to isolate application of a "New Zealand recourse only" test to specific members of the group. Otherwise, it will be difficult to demonstrate compliance with this requirement in the absence of debt raised on very specific terms.

2.31 Finally, we also consider that a blanket prohibition against associated credit support is unduly restrictive. We do not consider that the use of credit support outside the New Zealand group is necessarily indicative of debt that is not genuinely employed in support of the New Zealand operations.

Russell McVeagh

Group level versus entity level

2.32 The Issues Paper proposes that the new general rule should apply on a New Zealand group basis rather than on an entity-by-entity basis. It is stated in paragraph 6.35 of the Issuers Paper that "this requirement is necessary to ensure that entities within the same New Zealand group would not each apply different tests to get the benefit of each test".

2.33 We do not consider that providing taxpayers with the ability to apply different thin capitalisation tests necessarily undermines the overall integrity of the rules. We do not consider that the example provided in paragraph 6.35 of the Issues Paper should necessarily be regarded as offending the policy of the thin capitalisation rules having regard to the policy objectives that underpin the Issues Paper. If the new rule is complied with in relation to certain New Zealand members (given the nature of the assets and the particular debt terms) and the existing safe harbour debt threshold is complied with in relation to other members, we do not consider that that should give rise to an unacceptable tax policy outcome.

2.34 As noted above, it may be difficult for a taxpayer to establish that the general rule has been satisfied and that debt has been raised specifically to support New Zealand assets or business operations. We therefore consider that taxpayers should have the option of limiting the application of a "New Zealand recourse only" test to particular members of the group or particular investments.

Yours sincerely

s 9(2)(a)

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