The Treasury

Budget 2013 Information Release

Release Document

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Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government

[2] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial

[3] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[4] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[5] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[6] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[7] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[8] 9(2)(h) - to maintain legal professional privilege

[9] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[10] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[11] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[12] Not in scope

[13] 7(b) - to prevent prejudice to relations between any of the Governments of New Zealand, the Cook Islands or Niue

[14] 9(2)(ba)(i) - to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, an [4] appearing where information has been withheld in a release document refers to section 9(2)(b)(ii).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

POLICY ADVICE DIVISION

THE TREASURY
Kaitohutohu Kaupapa Rawa

Briefing note

Reference:	PAD BN2013/4, T 2013/85
Date:	31 January 2013
To:	Gary White, Office of the Minister of Finance Maraina Hak, Office of the Minister of Revenue
cc:	Deputy Commissioner, Policy [7] , PA to Deputy Commissioner
From:	Andrea Black and Fiona Mules (The Treasury) Tony Booth (Inland Revenue)
Subject:	**Thin capitalisation proposals and public private partnerships**

You have asked whether the proposed changes to the thin capitalisation rules could make Public Private Partnerships (PPPs) more expensive for the government with the effect that a carve-out from the rules would be appropriate.

Background

Thin capitalisation proposals

On 14 January 2013, the Minister of Revenue released an officials' issues paper which proposed to widen the application of the thin capitalisation rules. The proposal would bring into the rules non-residents who 'act together' to invest in New Zealand. This would include some PPP investors.

The proposal has been designed so that investors using genuinely third-party debt (e.g. bank debt as opposed to shareholder debt) should not be affected. Allowing this third party debt is a significant concession. In contrast, the existing rules take into account *all* interest-bearing debt, whatever its source, to reduce the risk that shareholder debt will be disguised as third party debt.

> Example: Three non-residents act together to invest in New Zealand. They capitalise a New Zealand company with $10 million of equity and the company borrows $90 million from an unrelated bank. The proposed changes to the thin capitalisation rules should not affect the investment.
>
> If instead the $90 million was borrowed from the three non-resident shareholders, the proposed changes would affect the investment.

Previous advice

To date Treasury has not supported calls for tax concessions or exemptions for PPPs as to do so could have wider implications for other transactions involving the government and the private sector, and for private-to-private transactions. This is because it would have the appearance of the government simply making rules to suit its own purposes and would encourage lobbying by other industries that have transactions with the government.

Effect of proposed rules on PPPs

Our view is that the proposals in the issues paper will have little or no effect on the way PPPs are currently being financed and, by extension, little or no effect on the gross cost to the government. For this reason officials' previous advice did not include a discussion of a potential exclusion from the proposals for PPPs *[Officials issues paper – thin capitalisation T2012/3107; PAD2012/257 refers].*

The target of the proposals is high levels of *shareholder* debt, as it can be an almost perfect substitute for equity, rather than debt per se. Actual and potential PPPs that we are aware of typically have high levels of bank debt and low levels of shareholder debt and so the proposals should have little or no impact. Treasury does not expect that the PPP model will move away from high levels of external bank debt in the short to medium term[1] as this is the cheapest form of finance available to a consortium.

[4]

The view of the Treasury is that such a potential reduction would not have a material impact on consortia's ability to bid within the affordability threshold set by the government which includes competitive neutrality adjustments for "regular" tax in any event. We also do not believe that such a change will cause a reduction in the interest of potential investors despite the 'noise' that the market may create around this. It is for this reason that our previous advice did not discuss the need for special rules for PPPs.

Potential options

While we do not expect there to be a more-than-minor effect on the PPP programme, if there were one it would not be directly through the imposition or removal of tax, both of which are government transfers. Rather, it would be due to a reduction in the number of potential bidders reducing competition in the bidding process.

It is important to note that there has always been different tax treatment for some PPP investors. For instance, the thin capitalisation rules currently limit the amount of debt that a non-resident could use if they were bidding for a PPP alone, whereas they do not limit the amount of debt used by a consortium of non-residents. The proposals move the boundary to align the treatment of more, but not all, non-residents with each other.

If, in spite of the views expressed above, it is decided that the proposed changes for the PPP programme will have an unacceptable effect, some further accommodation is of course possible. But in our view the potential options would not be minor "tweaks".

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1 There are currently no other forms of financial instrument available in the New Zealand or Australian market that can achieve the same objective. While this may change in the future, Treasury does not expect this to occur in the short to medium term.

[4]

They could have significant effects and could create unhelpful precedents that would undermine the core policy, or could involve even further widening of the thin capitalisation rules, an option which is presumably not favoured by PPP investors.

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