The Treasury

Reform of the Overseas Investment Act Information Release

July 2020

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

[2] 6(b)(i) - to avoid prejudice the entrusting of information to the Government of New Zealand on a basis of confidence by the Government of any other country or any agency of such a Government

[4] 6(c) - to avoid prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

Joint report: Treasury (International Team) and Inland Revenue (Policy): Overseas Investment Act Phase 2 reform - advice on considering tax as part of the Act's screening regime

Date:	14 November 2019	**Report No:**	T2019/3594 IR2019/472
		File Number:	IM-5-3-8

Action Sought

	Action Sought	Deadline
Associate Minister of Finance (Hon David Parker)	**Consult** with Minister of Revenue, Minister of Finance, Associate Ministers of Finance (Hon Dr David Clark and Hon Shane Jones) Minister for Land Information on the contents of this joint report. **Indicate** your policy decisions on proposals to introduce new tax components to the Act **Refer** this paper to Associate Ministers of Finance (Hon Dr David Clark and Shane Jones) and the Minister for Land Information	23 November 2019
Minister of Revenue (Hon Stuart Nash)	**Consult** with the Associate Minister of Finance (Hon David Parker) on the contents of this joint report.	23 November 2019
Minister of Finance (Hon Grant Robertson)	**Consult** with the Associate Minister of Finance (Hon David Parker) on the contents of this joint report.	23 November 2019

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Hugo Van Dyke	Analyst, Treasury	[39]	N/A (mob)	✓
Megan Noyce	Principal Advisor, Treasury	[39]	[23]	
Paul Kilford	Policy Lead, Inland Revenue	[39]	N/A (mob)	
Trish Ieong	Senior Policy Advisor, Inland Revenue	[39]	N/A (mob)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Joint Report: Treasury (International Team) and Inland Revenue (Policy): Overseas Investment Act Phase 2 reform - advice on considering tax as part of the Act's screening regime

Executive Summary

Purpose and background

This report seeks decisions on whether, and if so how, tax should be considered separately as part of the screening process under the Overseas Investment Act 2005 ('the Act').

The Terms of Reference for the Phase Two reform of the Act asked for consideration of tax in the screening process. In its report on the overall reforms to the Act (T2019/1649), Treasury recommended that tax should not be considered separately (but tax offences, like any other criminal offence, and other serious misconduct could be considered as part of the investor test).

You (Associate Minister of Finance (Hon Parker)), the Associate Minister of Finance (Hon Dr Clark) and the Minister for Land Information sought further advice on other options to consider tax in the screening process. Due to timing issues, DEV authorised you to make decisions on proposals to consider tax as part of the screening process, in consultation with the Minister of Revenue, Minister of Finance, Associate Ministers of Finance (Hon Dr Clark and Hon Jones) and the Minister for Land Information (DEV-19-MIN-0306). This joint report is copied to the Minister of Finance and the Minister of Revenue. We recommend that you refer it to Associate Ministers of Finance (Hon Dr Clark and Hon Jones) and the Minister for Land Information.

The Act is not the appropriate lever to address tax concerns

While we consider that serious breaches of tax law are relevant to determining an investor's character (like any other serious misconduct), we do not consider that the Act is the best tool to respond to risks of overseas persons not paying an appropriate amount of tax. The Act only covers 15% of foreign investment into New Zealand and can therefore never be a complete response to concerns about tax compliance by overseas investors. Tax law can, however, respond to the issues in a comprehensive and uniform way across all entities doing business in New Zealand.

New Zealand's tax system has been subject to a series of reviews over the last few decades, and our current international taxation framework is a result of those reviews. It is robust by international standards. In particular, the Base Erosion and Profit Shifting (BEPS) measures enacted in 2018, together with Inland Revenue's compliance approach for multinationals, have sharply reduced opportunities for foreign investors to erode New Zealand's tax base. Although the digitalisation of the economy continues to pose taxation challenges, officials are engaged in ongoing efforts to address them within the tax system (both unilaterally and multilaterally).

Options

We have developed five potential reform options, should you decide that tax be given special consideration in the Act: two options, which modify the investor test ('investor test options'); and three complementary options, which are a negatively framed factor in the benefits test, a requirement to share tax information with Inland Revenue, and a test applying to all transactions involving significant business assets.

Investor test options

The investor test options would apply to all screened investments. DEV has agreed to make changes to the investor test (DEV-19-MIN-0306), so that only civil penalties can be considered if they are imposed by a court.

- **Recommended option**. Expand the investor test to allow serious tax defaults and shortfall penalties for tax evasion and avoidance (and their equivalents in other jurisdictions) to be considered as part of the investor test, even if they are imposed by a tax authority.

- **Alternative option.** Expand the investor test to allow broader tax considerations, such as tax disputes, residency in a low tax jurisdiction, and tax minimisation to be considered.

We note that our recommended option is different from the treatment of other civil penalties. As Treasury advised in T2019/1649, in the case of tax we consider it sensible to allow penalties for tax evasion and avoidance to be considered due to the seriousness of those activities. In our view they are comparable to court-imposed (pecuniary) penalties even though in some jurisdictions they are imposed by a tax authority rather than a court.

We strongly recommend against the alternative investor option. It would significantly increase uncertainty, increase compliance costs, increase risks of irrelevant considerations being taken into account, and run counter to the objectives of the investor test reforms agreed to by DEV. We also have concerns it would not be enforceable in practice, as it relies heavily on full declaration by the applicant and facts being in the public domain. As most countries have tax secrecy laws, there is a high chance the information provided by the applicant could never be verified by the Overseas Investment Office ('OIO') or Inland Revenue.

Benefits test option

The benefits test only applies to investments involving sensitive land or fishing quota regardless of their value. For any additional tax test, we recommend that the benefits test option should be further confined to investments involving both sensitive land (or fishing quota) and significant business assets (generally, transactions where the asset is valued at $100 million or more). This is because higher value assets are likely to pose the greatest risk to New Zealand's tax revenue.

- **Complementary option 1**. Include a factor in the benefit tests that considers whether an investment involving significant business assets and sensitive land presents a risk to New Zealand's tax revenue. Inland Revenue would help administer this option by providing a high-level risk review. This would require a small amount of additional funding for Inland Revenue.

New options

The new options do not fit within the Act's existing or proposed architecture and would be new additions to the Act.

- **Complementary option 2.** Introduce a new information disclosure requirement whereby investors would have to disclose information on their proposed investment structure and tax treatment to Inland Revenue. This disclosure would not affect the consent decision.

- **Complementary option 3.** Introduce a new negatively framed test applying to all investments involving significant business assets that considers whether the investment will present a risk to tax revenue. This is the same as complementary option 1 except it would apply to all significant business assets, not just those involving sensitive land or fishing quota.

Recommendations on benefits test options and new options

We do not recommend the benefits test option or either of the new options, as we do not consider their abilities to manage the risks of overseas investment outweigh their costs.

However, of these options, we prefer complementary options 1 and 2 as they indirectly support Inland Revenue's ability to manage tax risks within the tax system and encourage investors to be more compliant. Complementary option 1 also provides a limited ability to manage tax risks through the Act but comes with greater administrative cost and substantially reduces the Act's coherency. For that reason, complementary option 2 is Treasury's preferred option of the two. Inland Revenue is indifferent between the two options, depending on funding.

We strongly recommend against Complementary option 3. Complementary option 3 would significantly complicate the coherency of the Act and the Phase 2 reforms' simplification objective (without greatly increasing the government's ability to manage risk), which risks tipping the reforms' balance towards managing risk (rather than simplification).

[1,36]

Next steps

You are meeting with us, and with the Minister of Revenue, Associate Ministers of Finance (Hon Dr Clark and Hon Jones) and the Minister for Land Information to discuss this advice on 19 November 2019.

The Government has indicated it intends to enact these reforms by mid-2020. To achieve this, decisions need to be made by 23 November so tax related proposals (if any) can be included in the second tranche of drafting instructions.

Communications

We understand that the policy decisions made by DEV (DEV-19-MIN-0306) are due to be announced on 19 November 2019. Policy decisions that tip the balance of the reform package more towards managing the risks of investment, rather than simplifying the regime, will need careful communication.

Given none of the complementary options were included in the Consultation Document, Inland Revenue's preferred approach would be to conduct targeted consultation if one of those options is chosen.

Recommended Action

We recommend that you:

a **Note** that DEV authorised the Associate Minister of Finance (Hon Parker) to take decisions on proposals to consider tax related matters as part of the screening process under the Overseas Investment Act 2005 (‘the Act’) in consultation with the Minister of Revenue, the Minister of Finance, the Associate Minister of Finance (Hon Dr Clark), the Minister for Land Information and the Associate Minister of Finance (Hon Jones)

b **Note** that Treasury previously provided advice on options for incorporating tax into the screening regime in T2019/1649, and that:

i no decision was made on the options proposed, and

ii the Associate Minister of Finance (Hon Parker), the Associate Minister of Finance (Hon Dr Clark) and the Minister for Land Information directed Treasury officials to provide joint advice with Inland Revenue, which would include additional options that would better allow decision makers to consider whether an applicant has in the past, or is likely to in New Zealand, employ tax minimisation practices, because such practices:

- would likely have a negative impact on New Zealand’s tax revenue, and
- would undermine the competing New Zealand companies that were paying sufficient tax in New Zealand.

c **Note** that the complementary options (recommendation m, below) are significantly different from those that were consulted on.

d **Note** that the proposed options may have financial implications for the Overseas Investment Office and Inland Revenue. Treasury will provide further advice on those financial implications after decisions are taken on the proposals in this report.

e **Note** that each of the options will require an information sharing agreement between the Overseas Investment Office and Inland Revenue.

Investor test options

f **Note** that DEV approved changes to the investor test (DEV-19-MIN-0306), which limit the factors decision-makers can consider when assessing an investor’s character to whether they have:

i been convicted of an offence for which they have been sentenced to imprisonment for a term of five years or more, or, at any time in the preceding ten years, been convicted of an offence for which they have been sentenced to imprisonment for a term of 12 months or more

ii had any civil contraventions resulting in pecuniary penalties, or entered into any enforceable undertakings, in the preceding 10 years, and

iii allegations of offences or civil contraventions (for which the maximum penalty is at least equivalent to the penalties referred to above) against them for which official proceedings have commenced.

g **Note** that Treasury advice in T2019/1649 noted that:

i changes to the investor test approved by DEV would mean that some serious penalties imposed by tax authorities (as opposed to Courts) could not be considered by decision-makers, and

ii Treasury would provide further advice to ensure serious penalties imposed by tax authorities could be considered.

h **Note** that there is a choice between two options to expand the tax matters that can be considered under the investor test (recommendations i.i. or i.ii., below), or to maintain the position agreed to by DEV (recommendations i.iii. and f.).

i Either: (*preferred option*):

i **Agree** with Treasury and Inland Revenue's recommended option to allow decision-makers to consider under the good character component of the investor test:

- penalties for evasion or similar act under section 141E of the Tax Administration Act 1994 (TAA) or an equivalent in another jurisdiction
- penalties for abusive tax position under section 141D of the TAA or an equivalent in another jurisdiction
- tax defaults, where the investor (or relevant overseas person) has failed to pay an amount of tax payable of NZ$5 million or more, and
- allegations of the matters described above once penalties have been imposed.

Agree/disagree.

OR (*not recommended)*

ii **Agree** with the alternative investor test option to allow decision-maker to consider an investors previous tax compliance history and tax disputes, residency in a low tax jurisdiction, and any previous tax minimisation behaviour.

Agree/disagree.

OR (*status quo)*

iii **Agree** to not incorporate any tax specific factors into the good character component of the investor test.

Agree/disagree.

Complementary options

j **Note** that there is a choice between three options, which could be complementary to the investor test options, focused on the tax risks of the investment (recommendation m.).

k **Note** that Treasury and Inland Revenue do not recommend any of the complementary options because we consider that tax law is the best tool for responding to concerns about tax compliance by overseas investors.

l [36]

m Either: (*preferred option*):

i **Agree** to maintain the status quo where tax is not considered as part of the benefits test, consistent with advice from Inland Revenue and Treasury.

Agree/disagree.

OR (*not recommended*):

ii **Agree** to include a negatively framed factor in the benefits test that would require applicants to disclose information on their tax structure to Inland Revenue and under which Inland Revenue would:

- consider the tax risks posed by an investment involving sensitive land or fishing quota, and significant business assets
- advise the decision-maker of any risks, including whether conditions could be imposed to offset that risk, so that the decision-maker could weigh those risks as part of the benefits test.

Agree/disagree.

OR (*not recommended*):

iii **Agree** to require applicants to disclose information on their tax structure to Inland Revenue.

Agree/disagree.

OR (*not recommended)*:

iv **Agree** to introduce a new negatively framed test that would require applicants to disclose information on their tax structure to Inland Revenue and under which Inland Revenue would:

- consider the tax risks posed by any investment involving significant business assets against the benefits of the investment, and
- advise the decision-maker of any risks, including whether conditions could be imposed to offset that risk.

n **Refer** this report to:

i Associate Minister of Finance (Hon Clark)

ii Associate Minister of Finance (Hon Jones), and

iii Minister for Land Information.

Refer/Not referred.

o **Note** that we are meeting with you, the Minister of Revenue, Associate Ministers of Finance (Hon Dr Clark and Hon Jones), and the Minister for Land Information to discuss this report on Tuesday, 19 November 2019.

[23]

Megan Noyce
Principal Advisor, Treasury

Paul Kilford
Policy Lead, Inland Revenue

Hon David Parker
Associate Minister of Finance

Joint Report: Overseas Investment Act Phase 2: Decisions on proposals to consider tax as part of the screening regime

Purpose of Report

1. On 13 November 2019, DEV authorised you (Associate Minister of Finance (Hon Parker)) to take decisions on proposals to consider tax related matters as part of the screening process under the Overseas Investment Act 2005 ('the Act') in consultation with the Minister of Revenue, the Minister of Finance, the Associate Minister of Finance (Hon Dr Clark), the Minister of Land Information and the Associate Minister of Finance (Hon Jones) (DEV-19-MIN-0306).

2. This report seeks your decisions on whether tax should be considered, and options for doing so.

3. You, the Minister of Revenue, Associate Ministers of Finance (Hon Dr Clark and Hon Jones), and the Minister for Land Information are meeting with officials from Treasury and Inland Revenue on 19 November 2019 to discuss this advice.

Background to Phase 2 reforms

Terms of reference for Phase 2

4. In October 2018, Cabinet agreed to Terms of Reference for the Phase 2 reforms to the Overseas Investment Act 2005 ('the Act') (CAB-18-MIN-0481 refers).

5. The Terms of Reference specified the Phase 2 reform's aim (having regard to the Act's purpose "that it is a privilege for overseas persons to own and control sensitive New Zealand assets") as:

    a enabling the government to effectively manage overseas investment, while

    b ensuring that the Act operates efficiently and effectively, and

    c supporting overseas investment in productive assets.

6. These objectives reflect:

    a the balance the Act seeks to strike between: supporting the foreign investment New Zealand needs to support productive growth and improve living standards, and managing any risks associated with that investment, and

    b that the Act does not have that balance right, hence the need for reform.

7. Among other things, the scope of Phase 2 included consideration of whether it was appropriate to include tax residency in the benefits test. We understand that this was included in response to concerns about:

    a overseas persons acquiring sensitive New Zealand assets and paying a low level of income tax in New Zealand

    b overseas persons obtaining a competitive advantage against New Zealand firms, which may pay more tax, and c poor tax behaviour outside of New Zealand by overseas persons acquiring sensitive New Zealand assets.

8. This could be viewed as contrary to the Act's purpose, which recognises that it is a privilege for overseas persons to own or control such assets.

9. Due to the limited relevance of tax residency for determining any tax risk associated with an investment,[1] we have considered whether tax considerations should form part of the screening process, generally.

Role of the Act

10. The Act requires overseas persons[2] to get consent before acquiring sensitive land,[3] significant business assets (generally transactions where the value of assets exceeds $100 million) or fishing quota. This requirement reflects the Act's purpose: that it is a privilege for overseas persons to own sensitive New Zealand assets. The Act captures approximately 15% of foreign direct investment into New Zealand.

11. The test that the overseas person must satisfy to obtain consent depends on the type of sensitive asset being acquired. If:

    a *Significant business assets* are being acquired, the overseas person must only satisfy the investor test, which focuses on the characteristics of the overseas person.

    b *Sensitive land or fishing quota is being acquired*, the overseas person must satisfy the investor test and the benefits test, which requires the overseas person to deliver certain benefits to New Zealand, unless:

        i residential land is being acquired, then there are a number of tests that largely focus on the land's use, or whether the applicant intends to reside in New Zealand indefinitely, or

        ii forestry activities will occur on the sensitive land, then the overseas person must satisfy the investor test and either two of: the streamlined benefits tests or the general benefits test.

12. DEV has also agreed to introduce a national interest test (DEV-19-MIN-0306 refers). This will serve as a backstop tool to manage significant risks associated with transactions already screened under the Act. This is a reserve power, which is designed to only be used with respect to transactions that pose a significant threat to New Zealand's national interest. [34]

[1] The Consultation Document noted that tax residency in itself does not involve consideration of a taxpayer's character or their tax contribution. In particular, an applicant will usually form part of a larger corporate group involving some non-residents. The tax residence of the immediate purchaser company is unlikely to make a difference to the tax risk of the overall investment.
[2] Broadly speaking, non-New Zealand citizens and resident, and bodies corporate, trusts and other unincorporated entities that are 25% or more owned or controlled by overseas persons.
[3] This includes non-urban land over five hectares, residential land and lifestyle land, and land adjoining sensitive areas such as the foreshore.

13. The Act currently requires any breach, or allegations of a breach, of tax law by individuals with control to be considered in the investor test.[4] The changes agreed to by DEV will alter this position by:

    a allowing decision-makers to consider tax offences or contraventions committed by bodies corporate (as well as individuals) as part of the investor test, and

    b limiting the matters that can be considered to civil contraventions and offences where they result in certain levels of imprisonment or pecuniary penalties. This will mean decision-makers can no longer consider some allegations of breaches, tax defaults, or serious tax penalties (e.g. shortfall penalties for matters such as tax evasion) which can be imposed by tax authorities rather than a court (that is, they are administrative penalties rather than pecuniary penalties). Treasury acknowledged this in T2019/1649 noting that it would provide further advice on how the proposed investor test could be expanded to include penalties imposed by tax authorities in consultation with Inland Revenue.[5]

14. The changes agreed to by DEV were consistent with the recommendations in T2019/1649 and are aimed at ensuring that only material risks are considered. They will significantly increase certainty and reduce compliance costs for investors and reduce administrative costs for the OIO.

15. The Act does not currently allow tax to be considered under the benefits test.

Public consultation highlighted mixed views on introducing additional tax considerations

16. A public consultation document ('Consultation Document') was released in April 2019 (DEV-19-MIN-0078). The Consultation Document included options to:

    a expand the matters decision-makers could consider under the investor test to include, for example, tax disputes and residency in a low tax jurisdiction, and

    b require investors to obtain a binding ruling from Inland Revenue as part of the screening process.

17. The business community strongly opposes any change to the status quo and considers that the OIO is not well equipped to evaluate (especially foreign) tax compliance. They consider New Zealand's existing tax laws already address ongoing tax compliance with respect to the investment, and that the investor test appropriately considers an investor's past compliance record.

18. Should the Government decide to introduce tax considerations (i.e. as a second best option after the status quo, which is considering tax misconduct under the investor test), a small number of business submitters, including the Corporate Taxpayers Group[6] favoured requiring larger investments to obtain a binding ruling from Inland Revenue.[7]

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[4] The recommendations for the investor test agreed to by DEV (DEV-19-MIN-0306 refers) limited the matters that decision-makers may consider as part of the investor test to whether the investor has:

- been convicted of an offence for which they have been sentenced to imprisonment for a term of five years or more, or, at any time in the preceding ten years, been convicted of an offence for which they have been sentenced to imprisonment for a term of 12 months or more
- had any civil contraventions resulting in pecuniary penalties, or entered into any enforceable undertakings, in the preceding 10 years, and
- allegations of offences or civil contraventions (for which the maximum penalty is at least equivalent to the penalties referred to those above) against them for which official proceedings have commenced

[6] The Corporate Taxpayers Group is a body of 45 large taxpayers. A number of other submitters, including BusinessNZ, also deferred to its submission on tax matters.

[7] Option 3 in the Consultation Document was to require overseas persons to obtain a binding ruling from Inland Revenue that the tax arrangements relating to the investments comply with New Zealand law.

A binding ruling is a decision by the Commissioner of Inland Revenue on the tax treatment of a transaction that binds the Commissioner (that is, the Inland Revenue cannot subsequently invalidate the tax consequences of the transaction on the basis that it involves tax avoidance). This option was included in the Consultation Document. However, we no longer consider it to be feasible as it would increase compliance costs and significantly reduce timeliness, without improving the Government's ability to manage tax risks.[8] The binding ruling option is therefore not covered in this report.

19. Most individual submitters consider that tax should be an important factor in determining consent. These submitters argue that overseas investors must pay for the services they receive and that previous tax compliance is a reliable indicator of future behaviour. Most individual submitters did not nominate a preferred option, but appear to prefer explicitly incorporating tax into the investor test.

Initial Treasury advice

20. In T2019/1649, Treasury proposed options for considering tax as part of the consent process for acquiring sensitive assets under the Act. Our recommended option was to continue to consider tax under the amended investor test. Our other options were to consider tax as part of the benefits test.

21. You did not make a decision on the options Treasury proposed. Associate Ministers of Finance (Hon Dr Clark and Hon Parker) and the Minister for Land Information directed Treasury and Inland Revenue to develop additional options which would better allow decision-makers to consider whether an applicant has in the past, or is likely to in New Zealand, employ tax minimisation practices, because such practices:

    a could likely have a negative impact on New Zealand's tax revenue; and

    b could undermine the competing New Zealand companies that were paying sufficient tax in New Zealand.

22. This report responds to that request by detailing two of the options proposed in T2019/1649 along with additional options designed to address your concerns.

23. This report does not cover the option to include a positively framed tax factor in the benefits test because it would only be considered if an investment had a positive impact on tax revenues. This is unlikely to occur in practice, as overseas persons will generally legitimately pay less New Zealand income tax (in accordance with New Zealand law) than New Zealanders where they are non-resident (just as New Zealanders would pay less tax in another jurisdiction).

DEV decision on reform options

24. On November 13, DEV authorised you to take decisions on these proposals in consultation with the Minister of Revenue, the Minister of Finance, the Associate Minister of Finance (Hon Dr Clark), the Minister of Land Information and the Associate Minister of Finance (Hon Jones) (DEV-19-MIN-0306).

25. That DEV decision also included substantial policy decisions on the reform package. These reforms were carefully calibrated to appropriately balance the objectives of reform by both:

    a increasing the Government's ability to manage investment in New Zealand's most sensitive and high risk assets, and

    b simplifying the decision-making process and removing transactions from the regime where screening is not needed to manage risk.

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[8] Between 2013 and 2015 the average fee for a binding ruling was $16,750 (excluding professional advisor fees) and the average time taken by Inland Revenue to reach a decision was three months.

26. There is a risk that some of the options included in this report – particularly complementary option 3 (and to a lesser extent, complementary option 1) which substantially alters the architecture of the screening process – will tip the balance of the reform package towards managing risk, rather than simplification. This would send a signal to investors that New Zealand is not open to the foreign direct investment we need.

The Act is not the appropriate lever to address tax concerns

The Income Tax Act provides a more comprehensive response

27. The Income Tax Act 2007 (Tax Act) and international tax agreements are the main tools for regulating income tax in New Zealand. This recognises that the imposition of income tax is an issue with domestic and international dimensions.

28. The taxation of foreign investment into New Zealand involves trade-offs. On one hand, New Zealand is a small, capital-importing nation and taxes can reduce the attractiveness of New Zealand as a place for non-residents to invest. On the other hand, protecting tax revenues from base erosion is important for public trust and confidence in the tax system, as well as to fund government spending.

29. New Zealand's tax laws aim to strike a considered balance between these trade-offs. New Zealand has had a series of tax reviews in the last few decades, which has resulted in the current framework. We consider New Zealand's tax system to be relatively robust by international standards. The Base Erosion and Profit Shifting (BEPS) measures enacted in 2018,[9] taken together with New Zealand's other existing base protection measures, have sharply reduced the potential for base-eroding (tax avoidance) transactions. In addition, in June 2019 Inland Revenue published a consultation paper on a possible digital services tax. Officials are also continuing to participate in OECD discussions aimed at reaching a multilateral solution to tax the digitalisation of the economy. The OECD is aiming to reach this solution by November 2020.

30. This year Inland Revenue refreshed its compliance approach for multinationals.[10] The refreshed approach recognises the new anti-BEPS measures and the resulting restructuring of multinationals from aggressive tax structures to more conservative ones. Inland Revenue closely monitors all significant enterprises with a turnover greater than $80 million, and all foreign-owned corporates with a turnover greater than $30 million. These entities are required to submit a basic compliance package (BCP) every year, consisting of their group structure, financial statements, and tax reconciliations. The information is run through Inland Revenue's internal risk review process and, based on the assigned rating, the entity may undergo further in-depth examination (including risk reviews and audits). Foreign-owned groups are also required to complete an annual international questionnaire, designed to collect key information about financing/debt and transfer pricing issues.[11] The purpose of the questionnaire is to monitor potential profit-shifting activities of major foreign-owned groups.

31. New Zealand's tax regime may impose a lower New Zealand tax burden on non-resident investors than on domestic investors. This is a feature of the international tax system – under our double taxation treaties, New Zealand resident investors would also usually face a lower tax burden in foreign jurisdictions to account for their obligation to pay New Zealand tax. One of the main reasons for this is due to the

[9] BEPS is a strategy used by multinationals to 'shift' profits from a higher tax jurisdictions to lower tax jurisdictions. The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 was enacted to curb that behaviour.

[10] Inland Revenue *Multinational Enterprises: Compliance Focus 2019* (launched November 2019).

[11] *Multinational Enterprises: Compliance Focus 2019* at 7.

ability of non-resident investors to finance New Zealand companies with related party debt (within the limits of our tax law). Despite this, we consider it unlikely that a lower New Zealand tax burden allows non-resident-owned firms to outcompete domestic-owned firms. In competitive markets, prices are not only set based on firms' costs. Instead prices are largely set by the interaction of supply and demand.[12] Although non-resident investors may face a lower New Zealand tax burden on a New Zealand investment than domestic investors would, they will usually face an additional foreign tax burden in their home jurisdiction.[13]

32. Nevertheless, we accept that circumstances change over time and it is important to continually evaluate the tax system and respond to change. If the present balance is off, we consider that changes to the tax system, rather than to the Act, are a more comprehensive way to remedy this. Tax law can respond to the issues in a uniform way across all entities that do business in New Zealand.

In contrast, the Act can only respond to concerns in a limited way

33. The Act is New Zealand's principal tool for regulating foreign investment in sensitive New Zealand assets. It is not, however, the only or best tool for regulating foreign investors' conduct (other than ensuring conditions imposed on a consent are complied with). This is because:

    a the Act only covers 15% of foreign investment into New Zealand. It only applies to "overseas persons" (who may or may not be New Zealand tax residents) and only to investments involving significant business assets, sensitive land or fishing quota.[14] Entities may fall outside the definition of "overseas person" but still be a non-tax resident in New Zealand (e.g. a company controlled by New Zealand citizens with its place of effective management offshore) and have the same tax risks as inbound investments that are subject to the Act

    b overseas persons operating in New Zealand are – like domestic investors – subject to our laws governing their activities, including tax laws. These tax laws cover all tax activity within New Zealand not just a small subset of foreign direct investment, and

    c screening under the Act is transaction based (that is, it looks at the investment being screened rather than other New Zealand investments already held by the overseas person). This means that it may not be possible to address any tax risks that apply to the overseas persons' business as whole (rather than the individual investment) through the Act.

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[12] McLeod *Final Report – Tax Review 2001* (24 October 2001) at E.22.

[13] Even if the investment were held indirectly through a holding company in a tax haven, the ultimate investors would still be liable to tax in their home countries on dividends from that holding company.

[14] For example, a New Zealand citizen living abroad may be a non-resident for tax purposes but will not be an "overseas person" under the Act.

Options

34. We have developed five options for reform should you decide that changes should be made to further incorporate tax considerations into the Act. These are set out in the table below and assessed against the three key objectives of the reforms. Consistency with international obligations and other tax impacts are also assessed. Other tax impacts are not an objective of the reform so should not be given the same weight as the other criteria. The table is followed by more in-depth analysis of each option.

Options	***Impact summary***				
	Manages the risks of overseas investment	Supports overseas investment in productive assets	Encourages more predictable, transparent and timely outcomes	Other tax impacts	Risks of inconsistency with international obligations
Investor test options Each of these options can be implemented on its own or could complement any one of the complementary options.					
Recommended option: expand the good character component of the investor test to allow consideration of tax defaults and serious administrative penalties imposed on an investor by tax authorities (along with tax offences which can already be considered)	Neutral-moderately positive	Neutral	Neutral	Neutral	[1, 36]
Alternative option: including a limb in the good character component of the investor test which considers broader tax considerations of an overseas person such as tax minimisation by investors, tax disputes and residency in a low tax jurisdiction.	Neutral - Moderately positive	Strongly negative	Strongly negative	Neutral	[1, 36]
Benefits test option This option can be implemented on its own or could complement either of the investor test options.					

Options	*Impact summary*				
	Manages the risks of overseas investment	Supports overseas investment in productive assets	Encourages more predictable, transparent and timely outcomes	Other tax impacts	Risks of inconsistency with international obligations
Complementary option 1 (not recommended): include a factor in the benefit tests that considers whether an investment involving significant business assets and sensitive land (or fishing quota) presents a risk to New Zealand's tax revenue.	Moderately positive	Moderately – strongly negative	Moderately – strongly negative	Additional tax information for IR	[1, 36]
New options Each of these options can be implemented on its own or could complement either of the investor test options.					
Complementary option 2 (not recommended): adding a new information disclosure requirement to Inland Revenue, which does not affect the consent decision.	Neutral – moderately positive	Neutral - moderately negative	Moderately negative	Additional tax information for IR	[1, 36]
Complementary option 3 (not recommended): adding a new negatively framed test applying to all transactions involving significant business assets that considers whether an investment will present a risk to New Zealand's tax revenue.	Moderately positive	Strongly negative	Strongly negative	Additional tax information for IR	[1, 36]

Investor test options

35. Our view is that the best place to consider tax in the Act's screening regime is the good character component of the investor test. Tax compliance history, like other compliance history, is relevant to determining whether an investor is of sufficiently good character to invest in New Zealand. Accordingly, our recommended option ensures serious breaches of tax law are treated the same way as other comparable non-compliance even though the penalties involved may be imposed by a tax authority rather than a court.

36. While the alternative option may allow the decision-maker to consider behaviour the Government does not consider desirable, it would be:

   a extremely difficult to operationalise because of other countries' tax secrecy laws and because tax minimisation is not a defined term (most behaviour by companies could be considered tax minimising to a degree) so it would not be easy to identify, and

   b [1]

Recommended option: expand the good character component of the investor test to ensure serious tax penalties and tax defaults are included

37. On 13 November, DEV approved changes to the good character component of the investor test which would limit consideration to serious penalties imposed by a court (DEV-19-MIN-0306). In the case of tax, significant penalties (e.g. shortfall penalties for tax evasion) can be imposed by tax authorities rather than a court.[15] We noted this in T2019/1649.

38. Serious, deliberate breaches of tax law are relevant to determinations of character, and can be indicative of future action in New Zealand. There is a risk that removing decision-makers' ability to consider those breaches as part of the good character component of the investor test would reduce the Government's ability to manage the tax risks associated with foreign investment.

Tax matters which could be considered under the investor test

39. To ensure that decision-makers are able to consider serious contraventions of tax law, we recommend amending the good character component of the investor test so decision-makers can consider":

   a penalties for evasion or similar acts under section 141E of the Tax Administration Act 1994 (TAA) or an equivalent in another jurisdiction

   b penalties for abusive tax position under section 141D of the TAA or an equivalent in another jurisdiction, and

   c tax defaults, where the investor has failed to pay an amount of tax payable. To mitigate compliance costs, it may be sensible to set a threshold of NZ$5 million so that defaults under this threshold do not need to be considered. This would not include cases where payment has been made but was merely late.

40. Consistent with the changes to the investor test agreed to by DEV, this would be limited to:

   a matters within the previous 10 years, and

   b allegations of types of contraventions described above once penalties have been imposed.

41. This option is a more developed version of the option included in T2019/1649.

Why we recommend this option

Advantages

42. When combined with DEV's decision to change the investor test (DEV-19-MIN-0078 refers), this option would (compared with the current Act):

[15] We raised this point raised in T2019/1649 and offered to provide further advice.

a improve the Government's current ability to manage tax risks associated with overseas investment under the investor test when compared with the status quo (prior to DEV's decision). In particular, taken in conjunction with DEV's decision to expand the investor test to cover bodies corporate (as well as individuals), this option will ensure serious tax non-compliance by bodies corporates will also be able to be considered.

b increase certainty for investors with respect to disclosures – generally, it will be clear when an investor has received the penalties or committed the defaults described in paragraph 39, above.

Disadvantages

43. In some cases, there may be difficulty determining whether a penalty in another jurisdiction is equivalent to the penalty above. Similarly, there may be issues for investors in obtaining tax information from some jurisdictions, which could cause a delay in application times.

44. [34]

Alternative option: expand investor test to include matters such as tax minimisation, tax disputes and residency in a low tax jurisdiction

45. Under the alternative option, there would be a limb in the good character component of the investor test specifically concerning broader tax considerations relating to an overseas person. This may include their previous tax compliance history and tax disputes, residency in a low tax jurisdiction, and any previous tax minimisation behaviour. This alternative option would therefore allow decision-makers to take account of matters that were not illegal. Treasury included a form of this option in the Consultation Document.

Why we don't recommend this option

Advantages

46. This option may improve the government's ability to manage the risks associated with foreign investment because it would greatly expand the tax matters that can be considered under the investor test. This would reduce the likelihood of taxpayers with a record of undesirable tax behaviour investing in New Zealand.

Disadvantages

47. We do not recommend this option because:

    a It increases the risk of decision-makers taking account of matters where it is difficult to identify relevant issues. In particular "tax minimisation" is not a legal term. It is commonly used to describe behaviour that is **not** tax evasion or tax avoidance, but nevertheless has the effect of reducing tax to some degree. Moreover, different countries' tax systems can differ markedly, and neither the Overseas Investment Office ('OIO') nor Inland Revenue are familiar enough with all countries' tax systems to accurately judge in many cases which tax considerations overseas are relevant or what weight should be attached to them.[16] This could result in consent being denied to an investment that may benefit New Zealand overall, and potentially expose the government to a greater risk of judicial review.

    b Similarly we do not consider it appropriate to decline a transaction on the basis of an entity being incorporated in a low tax jurisdiction (noting that The Netherlands and Singapore are often considered low tax jurisdictions). Entities can be resident in low tax jurisdictions for legitimate reasons. For example, an investment fund may be taxed in the jurisdiction in which they earn their returns (the source jurisdiction) and their investors may also be taxed in the jurisdiction where they live (the investor jurisdiction). In such cases, investment funds may register in a low tax jurisdiction to ensure the fund will not be subject to a third layer of tax, but its returns could still be subject to New Zealand tax if New Zealand is the source jurisdiction. Entities may also be resident in low tax jurisdictions for reasons completely unrelated to tax, but because of the business opportunities available in that jurisdiction.

    c It would increase uncertainty, resulting in less predictable outcomes and slower decisions.

    d It increases the disclosure requirements of applicants, which would increase the time and cost of preparing applications. This increased time and cost would reduce New Zealand's attractiveness as a destination for foreign investment. The additional material disclosed would also require more time for OIO (and potentially Inland Revenue, given that OIO does not currently have the expertise to assess the legitimacy of a tax structure) to review, which would reduce timeliness of applications.

    e [34]

    f The reforms to the investor test have been calibrated to look at activity that poses material risks and not drive enquiry into low risk areas. These proposals would work against that objective.

[16] For example, in some jurisdictions formal proceedings is the first step in any disagreement between a taxpayer and a tax authority but in New Zealand most tax issues are resolved informally before a formal dispute commences. Similarly, presence in a low tax jurisdiction could be for legitimate reasons (e.g. conducting actual business in that jurisdiction; or to prevent economic double taxation), and may be irrelevant to an applicant's likelihood of behaving consistently with New Zealand's laws and norms.

Complementary options to the investor test options

48. We have developed additional options which would allow consideration of impacts of an investment on New Zealand's tax revenue. Each of these options are alternatives to each other but could be in addition to either of the investor test options.

49. The complementary options would increase the Government's ability to manage the risk of overseas investment to varying degrees. However, we do not recommend any of these options for the following general reasons:

    a the additional time and cost required to screen applicants for tax purposes could offset the measures that have been made to simplify the regime and remove unnecessary red-tape. This could reduce New Zealand's attractiveness to foreign investment

    b introducing a new test, or new component to the benefits test, would introduce additional complexity to the regime (particularly in the case of complementary option 3),

    c with respect to complementary options 1 and 3:

        i Inland Revenue would have to assess the consistency of any conditions imposed or decision to decline an investment for tax reasons for consistency with New Zealand's double taxation agreements, which could be time consuming in some cases, and

        ii [1]

    d most importantly, to reiterate paragraphs 27 to 33, tax law is the most effective tool to ensure that overseas investors pay an appropriate amount of tax in New Zealand. Any response through the Act will only apply to a small subset of overseas investors and address the problem in a very limited way.

Complementary option 1: include a negative factor in the benefits test related to the tax risks an investment may pose

50. Complementary option 1 was included in T2019/1649 but was not consulted on. This option would apply to transactions involving sensitive land (or fishing quota) that also involve significant business assets.[17] This would ensure that screening is targeted at transactions that pose the greatest risk to New Zealand's tax revenue.

51. Under this option, investors would disclose information about the tax structure of their transaction including forecast revenue and taxes. Inland Revenue would conduct a high-level review of that information and determine whether the transaction presents a risk to New Zealand's tax revenue or the integrity of the tax system, and provide a summary of its risk assessment to the decision-maker, which would form part of the benefits test (that is, it would be weighed against the benefits in the benefit test).

[17] Based on OIO application numbers over the past five years, we expect this would this result in between 13 and 22 applications being screened.

52. If risks were present, Inland Revenue could:

   a suggest that the overseas person adjust the structure or related party pricing of the investment such that a lower risk rating may be given, and/or

   b recommend that the OIO impose conditions on the applicant to mitigate any risk. If conditions were imposed the investor could be required to annually certify that those conditions had been complied with.

53. If the risks were not sufficient to justify the responses above (or if those responses were not considered appropriate), the decision-maker could factor in the risk when weighing the benefits of a transaction as part of the benefits test.

54. These measures would increase the Government's ability to manage tax risks associated with foreign investment because it would reduce the likelihood of overseas investment in sensitive New Zealand assets dramatically reducing tax from that asset.

55. It would also give Inland Revenue some visibility over overseas persons' tax arrangements. This would help Inland Revenue when monitoring those overseas persons for compliance with New Zealand tax law and would also help inform Inland Revenue's broader policy and audit functions by identifying emerging areas of tax risk. The Australian regime has a similar tool [2]

56. We also expect that the knowledge that Inland Revenue will be reviewing their investment structure and pricing, and potentially conducting some ongoing monitoring, may also encourage applicants to be more conscious of their tax obligations and make more conservative tax decisions than they otherwise might.

57. That being said, we understand that the benefits outlined in paragraphs 55 and 56 could also be obtained by introducing an information disclosure requirement and information sharing arrangement between Inland Revenue and OIO (see complementary option 2).

We do not recommend complementary option 1

58. However, we do not recommend complementary option 1 because of its broader negative effects on the regime. While DEV agreed to a negative benefit for water bottling, that would apply in very narrow set out circumstances (when compared to tax). Including a negatively weighted factor in the benefits test has a number of risks. For example, it would:

   a be difficult to determine the weight that factor should be given

   b require decision-makers to weigh incommensurate values – for example, the benefits of walking access against a potential tax risk, and

   c reduce the Act's coherence, increase complexity and costs for the OIO and applicants.

59. Complementary option 1 would also reduce timeliness, likely impacting proposals agreed to by DEV (DEV-19-MIN-0306), to impose timeframes on screening. The extent to which this would occur would depend on the level of review required of Inland Revenue. [2]

Due to differences in the New Zealand and Australian regime and resourcing, Inland Revenue estimates that it could be expected to take at least four weeks on average (some simpler applications will take less time, some more complex applications will take longer) to review an application.

60. Some degree of monitoring and enforcement would also be required to ensure investors implemented the structure and pricing they put forward in their application. We believe that Inland Revenue would be better placed than the OIO to carry out any monitoring in respect of tax. However, doing so would require Inland Revenue to deploy its resources to monitoring screened investments, even though there may be greater tax risks elsewhere. This is likely to have financial implications (see paragraph 91).

61. Finally, this option is also limited because it would only allow tax to be considered in respect of transactions to acquire sensitive land, not transactions involving significant business assets only.[18]

Complementary option 2: adding a new information disclosure requirement that does not affect consent decision

62. Complementary option 2 would require applicants (or the OIO) to provide Inland Revenue with details of their proposed investment structure and its tax treatment, including the pricing of related party transactions. While applicants would be required to provide this information for their OIO application to be considered, the information would not affect the consent decision or timeframes.

63. This option may marginally increase the Government's ability to manage risk for the reasons set out in paragraphs 55 and 56. As with complementary options 1 and 3, we also expect that the knowledge that Inland Revenue will have details of their investment structure may also encourage applicants to make more conservative tax decisions than they otherwise might.

64. Since Inland Revenue would not provide a risk assessment, it would be able to fund the few additional resources required from existing baselines.

65. To the extent additional information is required, this may also marginally increase compliance costs for applicants.

Complementary option 3: adding a new negatively framed test applying to all investments in significant business assets that considers the tax risks an investment may pose

66. This option is similar to complementary option 1 but would apply to all transactions involving significant business assets (not just those involving both significant business assets and sensitive land). This means it would have to be a separate test and additional layer of screening for transactions involving significant business assets because the benefits test only applies to transactions involving sensitive land.

[18] 29% of applications feature significant business assets and less than half of those are subject to the benefits test (because these transactions do not involve sensitive land).

67. The benefits of this option are similar to complementary option 1 but without the limitation of it only applying to transactions involving sensitive land. This would ensure the government is able to manage the tax risks of all investments over $100 million. By screening investments in significant business assets (rather than those involving sensitive land) for tax risks, the government would able to focus on investments of greatest tax risk – for example, those who can conduct much of their business without a physical presence and are therefore unlikely to acquire sensitive land or fishing quota.

We do not recommend complementary option 3

68. We strongly recommend against this option. It would fundamentally change the screening process as it applies to significant business assets by screening the investment rather than just the investor.

69. Under the amended investor test agreed by DEV, the decision-maker will only be able to consider an investor's character. Consistent with the status quo, the decision-maker will not able to consider any benefits or drawbacks of the investment. If this option were implemented, in order to make a balanced assessment of the tax risks of an investment, the decision-maker would also need to have regard to potential economic or other benefits of the investment (as is the case in the national interest test). This would effectively introduce an additional test that sits alongside the benefits test for transactions involving sensitive land, and introduce another layer of screening for transactions involving significant business assets.

70. This change would:

   a be a significant departure from how the Act currently distinguishes between acquisitions involving sensitive land (or fishing quota) and those that involve only significant business assets

   b substantially reduce timeliness of screening for significant business assets and (to a lesser extent) applications involving both sensitive land (or fishing quota) and significant business assets. Currently applications involving sensitive land or fishing quota (which are subject to the benefits test) can take two to three times longer to process than applications only involving significant business assets. Applying another test to significant business asset consents would make applications only involving significant business assets take much longer, and

   c have significant resourcing implications for the OIO and Inland Revenue.

71. When considered with other parts of the reform pack aimed at strengthening the government's ability to manage risk, this option could tip the balance of the reform package towards managing risk, rather than simplification. This would send a signal to investors that New Zealand is not open to the foreign direct investment we need.

Information sharing

72. Each of the complementary options would require an information sharing agreement between Inland Revenue and the OIO if implemented. The investor test options (particularly the alternative option) would also benefit from an information sharing agreement.

International implications

73. The international implications of individual changes to the investment screening regime are difficult to assess in the abstract. However, proposals that deviate further from the status quo are more likely to generate adverse attention from our trading partners.

[1, 36]

[1, 36]

[1, 36]

Financial implications

Overseas Investment Office

91. Each of these options may have financial implications for the OIO. Of the options proposed, we expect that complementary option 3 will result in the largest increase in costs for the OIO, followed by the alternative option and complementary option 1. We would not expect either the recommended option or complementary options to have material financial implications (if any) given that they do not substantially depart from the status quo (as agreed in DEV (DEV-19-MIN-0306)) in terms of additional work.

Inland Revenue

92. If either of complementary options 1 or 3 are introduced, there will also be financial implications as a result of Inland Revenue's costs of reviewing applications and monitoring investments. This is a new function and costs are unlikely to be able to be absorbed within baselines, or reprioritised.

93. Initial estimates are that these will be:

    a *Complementary option 1:* $240,000 to $400,000 per year (assuming 20 applications, for sensitive land (or fishing quota) applications also involving significant business assets), or

    b *Complementary option 3:* $480,000 to $600,000 per year (assuming 40 applications, for all significant business asset applications).

94. We will provide further advice on the financial implications, including whether the additional costs can be recovered through fees, following your decisions on options.

Public consultation

95. The options proposed have not been consulted on, except for the Alternative option. We consider that the recommended option is sufficiently similar to the status quo (tax compliance being considered under the investor test) so further public consultation is not necessarily required.

96. However, none of the complementary options, which are substantially different to those included in the Consultation Document, were consulted on. Without public consultation, there is a risk that we have not identified implications of the options. Inland Revenue also have highlighted that there is also a risk that there will be an adverse reaction if it is released without having undergone any public consultation. We expect this will be most pronounced with complementary options 1 and 3, which may be interpreted as requiring entities to pay more tax than is otherwise legally required.

97. Our preferred approach would be to conduct targeted consultation on the complementary options before introduction but this would result in delays that could compromise your ability to enact the Phase 2 reforms.

Departmental consultation

98. In preparing this report, we have consulted with Land Information New Zealand (including the OIO), Ministry of Foreign Affairs and Trade, the Ministry of Business, Innovation and Employment, the Ministry for Primary Industries, New Zealand Trade and Enterprise, the Ministry of Housing and Urban Development and the Department of Prime Minister and Cabinet (Policy Advisory Group).

99. Land Information New Zealand ('LINZ') agrees with Treasury and Inland Revenue that tax law is the best legal framework to address risks to tax base associated with overseas investment. They note that the level of overseas investment screened under the Act is a small proportion of total overseas investment inflows. Therefore, any amendment to the Act is unlikely to effectively address risks to the tax base.

100. If Ministers choose to leverage the overseas investment regime to address these risks, LINZ supports the paper's recommended option, namely allowing considering of tax defaults and serious administrative penalties imposed on an investor by tax authorities along with tax offences. Of all the options presented in the report, this approach is likely to have the least impact on investor confidence. It is also likely to be the most workable option for the OIO with fewer resourcing implications, and in turn knock-on impacts on fees charged to investors. Further work will be required to fully assess the impact and costs of the chosen option on the OIO and Inland Revenue.