

INTEREST APPORTIONMENT FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS

Including proposed amendments in the Taxation (International Investment and Remedial Matters) Bill
as reported from the Finance and Expenditure Committee on 9 May 2011

(All Clause references are references to this Bill. Section references are to the Income Tax Act 2007)

CONTENTS: (Page 1 of 2)

Page Nos.

When the rules apply from and which companies they apply to

- | | |
|--|---|
| (1) When do the rules apply from? | 3 |
| (2) Which NZ trustees do the rules currently apply to? | 3 |
| (3) Which additional NZ trustees will the extended rules apply to? | 4 |

The debt percentage threshold

- | | |
|--|---|
| (4) What is the debt percentage threshold over which income will result? | 5 |
|--|---|

The NZ group

- | | |
|---|---|
| (5) What is the trustee's "NZ group"? | 5 |
| (6) What if the trustee has ownership interests in members of 2 different groups? | 5 |

Group debt percentage

- | | |
|--|---|
| (7) How is the group debt percentage calculated? | 6 |
| (8) What are the measurement rules? | 7 |
| (9) What financial arrangements can be excluded under the on-lending concession? | 7 |

Exceptions

- | | |
|--|-------|
| (10) When will there be no income even if the debt % threshold is breached? | 8 & 9 |
| (11) When will there be only limited income if the debt % threshold is breached? | 10 |

The worldwide group

- | | |
|--|----|
| (12) When is it necessary to establish the worldwide group's members? | 10 |
| (13) Who are the members of the worldwide group? | 11 |
| (14) What happens when a trustee owns a CFC and a company in a separate group? | 11 |
| (15) How is the worldwide group's debt percentage calculated? | 12 |

Income under the standard formula

- | | |
|---|----|
| (16) How is income calculated under the standard formula when the debt % is breached? | 13 |
|---|----|

...continued on page 2

INTEREST APPORTIONMENT FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS

CONTENTS: (Page 2 of 2)

Page Nos.

The new threshold test

(17) What is the proposed new threshold test and from when can it be used?	14
(18) What are the eligibility requirements to use the new threshold test?	14
(19) What is “adjusted net profit”?	15
(20) Exactly how is the threshold test performed?	16
(21) How is income calculated if the threshold is breached?	16
(22) What are the compliance requirements for using the new threshold test?	16

INTEREST APPORTIONMENT FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(1) When do the rules apply from?	(1) The rules apply to income years beginning on or after 1 July 2009. The proposed amendments contained in the Bill apply to income years beginning on or after 1 July 2011 (unless otherwise specified).
(2) Which NZ trustees do the rules currently apply to? <u>(Note: only the application to NZ trustees is considered in this document.)</u>	(2) The rules apply to an <u>excess debt entity</u> which, in relation to a trust, is a person that is a <u>NZ resident trustee of a trust settled by a NZ resident that has:</u> (a) An income interest in a CFC. (b) An ownership interest of 50% or more in or, control by any other means of, a NZ resident company (or its parent company with an ownership interest as described below) with an income interest in a CFC. (c) An ownership interest of 50% or more in, or control by any other means of, a NZ resident (parent) company with an ownership interest of 50% or more in, or control by any other means of, a NZ resident company with an income interest in a CFC. [s. FE 2(1)(g)]

	INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS
<p>(3) Which additional NZ trustees will the extended rules apply to?</p>	<p>(3) <u>A NZ resident trustee of a trust settled by a NZ resident that has:</u></p> <p>(a) <u>A direct income interest of 10% or more in an Australian resident FIF, for which no FIF income will arise due to the <u>new exemption</u> (proposed replacement for s. EX 35) for FIFs that are resident in Australia and subject to tax there. (The exemption will not apply to PIEs, unit trusts, GIFs, superannuation schemes and life insurers.)</u></p> <p>(i) <u>An interest of 50% or more in, or control by any other means of, a NZ resident company (or its parent company – see below) with a direct income interest of 10% or more in an Australian resident FIF to which the new exemption (proposed replacement for s. EX 35) will apply.</u></p> <p>(ii) <u>An interest of 50% or more in, or control by any other means of, a NZ resident (parent) company with an ownership interest of 50% or more in, or control by any other means of a company described above.</u></p> <p>[Clauses 45 & 24 of the Bill & proposed extension to s. FE 2(1)(g)]</p> <p>(b) <u>An interest in a FIF for which the trust is able to use (this excludes listed companies, PIEs, unit trusts, super schemes and GIFs) and uses, the new <u>Attributed FIF Income (AFI) calculation method</u> (proposed replacement for the Branch Equivalent (BE) method – see below) being a FIF interest that is:</u></p> <ul style="list-style-type: none"> • an income interest of 10% or more in a FIF that is a company; or • an income interest in a FIF that is a CFC, where the market value of the FIF at the beginning of the accounting period cannot be determined other than by an independent valuation (i.e. a FIF interest in a CFC whose shares are not widely traded). <p>(i) <u>An interest of 50% or more in or, control by any other means of, a NZ resident company (or its parent company – see below), with an interest in a FIF for which the company is able to use (this excludes listed companies, PIEs, unit trusts, super schemes and GIFs) and uses, the new <u>AFI calculation method</u>, being a FIF interest of a type described above.</u></p> <p>(ii) <u>An interest of 50% or more in, or control by any other means of, a NZ resident (parent) company with an ownership interest of 50% or more in or, control by any other means of, a company described above.</u></p> <p>[Clauses 45 & 26(3) of the Bill & proposed extension to s. FE (2)(1)(g)]</p> <p><u>AFI Method:</u> The AFI method proposed in Clause 29 of the Bill is based on the Attributed CFC Income method and will allow FIF holders to access the active income exemption currently available only to CFCs. If the active income exemption applies, there will be no FIF income as a result of using the AFI method. It is proposed that the AFI method can be used provided that sufficient information can be given to Commissioner to check the calculations, if required.</p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(4) What is the debt % threshold beyond which income will arise under the interest apportionment rules?	<p>(4) A trustee of a NZ trust that is an excess debt entity must calculate income arising under the interest apportionment rules if:</p> <p>(a) the NZ Group Debt percentage is more than 75%; and</p> <p>(b) the NZ Group Debt Percentage is more than 110% of the Worldwide Group Debt Percentage.</p> <p>[s. FE 5(1)(b)]</p> <p>(See (7) on page 6 for how the group debt percentage is calculated)</p>
(5) What is the trustee’s “NZ Group”?	<p>(5) The NZ Group of the trustee of an excess debt NZ trust is made up of the <u>trustee and all associated persons</u> who are not excess debt outbound companies and are not included in a NZ a group of an excess debt outbound company, and <u>who</u>–</p> <p>(a) are resident in NZ; or</p> <p>(b) are carrying on business in NZ through a fixed establishment in NZ; or</p> <p>(c) derive income, <u>other than non-resident passive income</u>, that has a source in NZ and for which relief from NZ tax under a double tax agreement is unavailable.</p> <p>[s. FE 3(2)(a) & proposed change in Clause 46 of the Bill underlined]</p>
(6) What if the trustee has ownership interests in members of 2 different NZ Groups?	<p>(6) The <u>members of 2 NZ Groups</u> (Group 1 and Group 2), <u>each of which has a member that is an excess debt outbound company, combine into a single NZ Group</u> if a trustee has:</p> <ul style="list-style-type: none"> • a 50% or more ownership interest in a member of Group 1; and • a 50% or more ownership interest in a member of Group 2. <p>[s. FE 29]</p>

**INTEREST APPORTIONMENT RULES
FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS**

(7) How is the group debt percentage calculated?

(7) The group debt percentage for an excess debt outbound company's NZ Group, and an excess debt outbound company's Worldwide Group is:

$$\frac{\text{Debts}}{\text{Assets}}$$

Debts: (see (8) on page 7 for the measurement rules)

- (a) Financial arrangements that provide funds to the Group, and give rise to deductions other than deductions only for movements in exchange rates.
- (b) Fixed-rate foreign equity or fixed-rate shares issued by the company or another NZ Group member, and held by NZ residents.
- (c) Stapled debt securities issued by the company or another NZ Group member, held by NZ residents, and stapled to shares other than shares of a company that is a proportional-stapling company.

On-lending concession: Debts do not include financial arrangements that provide funds to persons who meet the requirements of the on-lending concession in s. FE 13(3) (see (9) on page 7).

[ss. FE 15 & FE 13]

Assets: (measured under GAAP, using the measurement rules (see page 7)

- as valued in the financial statements of the NZ Group; or
- at their net current values; or
- valued at a combination of the above if allowed under GAAP.

(Trading stock can be valued at market value if that is the tax value. Personal property lease assets, under a specified or finance lease, that are not recognized under GAAP can be valued at their adjusted tax values.)

An investment in a CFC held by any NZ Group member and an investment of at least 10% in an Australian FIF or an investment in a FIF for which the AFI method is used, except to the extent to which the CFC or FIF derives income from NZ, other than non-resident passive income, for which there is no treaty relief.

(The underlined parts are proposed changes in Clause 51 of the Bill that are to apply to income years beginning on or after 1 July 2011)

On-lending concession: Assets and CFC and FIF investments do not include financial arrangements on-lent to which **section FE 13 applies** (see (9) on page 7).

[ss. FE 16, FE 13 & Clause 51 of the Bill]

Group debts and assets: (using the measurement rules in (8) on page 7):

Debts and assets of the NZ group are consolidated, to calculate the group debt percentage, using GAAP for the consolidation of companies.

If a group member is non-resident, the member's debt and assets are included in the consolidation only to the extent that:

- a business is carried on in NZ through a fixed establishment in NZ; or
- income (other than non-resident passive income) is derived from NZ for which there is no treaty relief. (Proposed change in Clause 50 underlined, to apply to income years on or after 1 July 2011.)

[s. FE 14(1) & (3) and Clause 50 of the Bill]

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(8) Measurement rules	<p>(8) Measurement dates: The total group debts and total group assets for an income year must be measured using 1 of the following methods:</p> <ul style="list-style-type: none"> • The average amount at the end of each day of the income year. • The average amount at the end of each quarter in the income year. • The amount at the end of the income year. <p>[s. FE 8]</p> <p>The choice is made by providing a return of income for the income year exercising the choice. A choice may be changed after a notice of assessment for the income year has been received.</p> <p>[s. FE 9]</p> <p>NZ currency: Total group debt, total group assets, and financial arrangements or risk-weighted exposures must be calculated in NZ currency. Foreign currency values must be converted using one of:</p> <ul style="list-style-type: none"> • The close of trading spot exchange rate for the foreign currency on the relevant measurement date. • The forward exchange rate on the 1st day of the income year for the relevant measurement date. <p>[s. FE 10]</p> <p>Anti-avoidance: Temporary increases or decreases in value that have a purpose or effect of defeating the intent and application of the interest apportionment rules must be ignored.</p> <p>[s. FE 11]</p>
(9) What financial arrangements can be excluded from debt and assets under the on-lending concession in section FE 13?	<p>(9) The outstanding balance of a financial arrangement, that would otherwise be included in a trustee of an excess debt NZ trust's group debt and assets, can be excluded if the financial arrangement provides funds, for an arms length consideration, to another person who:</p> <ul style="list-style-type: none"> • Is a non-resident, who <ul style="list-style-type: none"> ○ does not carry on business through a fixed establishment in NZ; or ○ derives only <u>non-resident passive income</u>, or NZ sourced income that is completely relieved of NZ tax under a treaty <u>(Proposed change in Clause 49B of the Bill underlined to apply to income years beginning on or after 1 July 2011.)</u> • Is not associated with the trustee. • Is associated with the trustee, but: <ul style="list-style-type: none"> ○ is not a member of the trustee's NZ Group; and ○ is a person subject to the interest apportionment rules. <p>World-wide group on-lending concession: When calculating the Worldwide Group's debt percentage, financial arrangements can be excluded under section FE 13 if, the person to whom funds are provided is not associated with the trustee of the excess debt NZ trust.</p> <p>[s. FE 13 & Clause 49B of the Bill]</p>

	INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS
<p>(10) What are the exceptions where income will not arise even if the debt % threshold is breached?</p>	<p>(10) <u>There are 3 exceptions under which a NZ trustee of a trust that is an excess debt outbound entity (“the trust”) will not have any interest apportionment income even if the debt percentage threshold is breached.</u></p> <p>Exception 1: Where the trustee’s NZ Group assets, (measured under GAAP with tax adjustments permitted for trading stock and some lease assets not recognized under GAAP), comprise at least 90% of the assets of the company’s Worldwide Group.</p> <p>[s. FE 5(1B)(a)]</p> <p>Exception 2: Where:</p> <ul style="list-style-type: none"> • The trustee’s NZ Group’s deductions for interest paid to lenders outside the Group does not exceed \$250,000; and • The trustee’s NZ Group does not include an entity with an income interest in a CFC that derives rent from land from its country of residence. <p><u>This exception is due to be replaced (see below) and will not be available from income years beginning on or after 1 July 2011.</u></p> <p>[s. FE 5(1)(b) and Clause 47(2) of the Bill]</p> <p>Replacement for Exception 2: Clause 47(1) - (4) of the Bill contains a proposal to replace this exception with the following:</p> <p><u>Where the trustee is eligible to use, and chooses to use, the proposed new threshold test, (see (17) to (22) below) and under that test, the trustee’s NZ Group’s interest-income ratio (see (20) below) does not exceed:</u></p> <ul style="list-style-type: none"> • 50%; and • <u>110% of the trustee’s Worldwide Group’s interest-income ratio.</u> <p>This replacement exception is to apply retrospectively from income years beginning on or after 1 July 2009.</p> <p>Upon enactment the replacement exception will be available in addition to the replaced exception for income years beginning between 1 July 2009 and 30 June 2011.</p> <p>[Clause 47(1) - (4) of the Bill: new ss. FE 5(1B)(ab) & FE 5(1BB) to FE 5(1F)]</p> <p>Exception 3: On the next page - page 9.</p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(10) Exceptions where there is no income (cont.)	<p><u>Exception 3:</u></p> <p><u>For returns filed before 20 June 2011 relying on s. FE 6(3)(ac)(ii) before its amendment:</u> The <i>trustee's finance cost</i> is not more than \$1,000,000.</p> <p><u>For returns filed on or after 20 June 2011:</u> The trustee's <i>NZ Group's finance cost</i> is not more than \$1,000,000.</p> <p>[s. FE 6(3)(ac)(ii) as amended by section 45(2), and section 45(5), of the Taxation (Tax Administration and Remedial Matters) Act 2011 – 20 June 2011 was the date on which the corresponding Bill was reported from the Finance and Expenditure Committee]</p> <p><u>Finance cost:</u> The trustee of an excess debt NZ trust's "finance cost" is the sum of the deductions for interest payable by the trustee to persons who are not in the trustee's NZ Group.</p> <p><u>Finance cost does not include:</u></p> <ul style="list-style-type: none"> • Deductions for interest on financial arrangements that do not provide funds to the trustee. • Deductions for interest on financial arrangements that do provide funds to the trustee, where the interest deductions arose only from exchange rate movements. <p>[ss. FE 6(2)&(3)]</p> <p><u>Group finance cost:</u> The Group finance cost is the total of each Group member's finance cost.</p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(11) What is the exception under which only limited income will arise if the debt % threshold is breached?	<p>(11) If the trustee's finance cost is between \$1,000,000 and \$2,000,000, the finance cost is adjusted downwards, for the purpose of calculating income under interest apportionment rules.</p> <p><u>For returns filed before 20 June 2011 relying on s. FE 6(3)(ac)(iii) before its amendment:</u></p> <p>The trustee's adjusted finance cost, for the purpose of calculating income, is:</p> $[\text{trustee's finance cost}] - [\$2,000,000 - \text{trustee's finance cost}]$ <p>[s. FE 6(3)(ac)(iii) before amendment]</p> <p><u>For returns filed on or after 20 June 2011:</u></p> <p>The trustee's adjusted finance cost, for the purpose of calculating income, is:</p> $[\text{trustee's finance cost}] - [\$2\text{m} - \text{NZ Group finance cost}] \times \frac{\text{trustee's finance cost}}{\text{NZ Group finance cost}}$ <p>[s. FE 6(3)(ac)(ii) as amended by section 45(2), and section 45(5), of the Taxation (Tax Administration and Remedial Matters) Act 2011 – 20 June 2011 was the date on which the corresponding Bill was reported from the Finance and Expenditure Committee]</p>
(12) When is it necessary to establish the Worldwide Group's members?	<p>(12) If the debt percentage of a trustee of an excess debt NZ trust's NZ Group is more than 75%, the trustee must calculate the debt percentage of its Worldwide Group.</p> <p>[s. FE 12(2)]</p> <p><u>If the proposed new threshold test in new section FE 6B is to be chosen, the trustee's Worldwide group must be established, as the eligibility criteria contain requirements that must be satisfied by the Worldwide Group, and the interest-income ratio calculations include calculations for the Worldwide Group (see (17) to (22) below).</u></p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(13) Who are the members of the Worldwide Group?	<p>(13) For an income year, <u>the Worldwide Group</u> of a trustee of an excess debt NZ trust consists of all of the following:</p> <ul style="list-style-type: none"> • The trustee. • The trustee’s NZ Group for the income year. • All CFCs in which the trustee or a member of the trustee’s NZ Group has an income interest. <p>[ss. FE 12(5) & FE 31B]</p> <p><u>Clause 46 of the Bill contains a proposal to include the following in a trustee’s Worldwide Group:</u></p> <ul style="list-style-type: none"> • <u>All FIF interests in Australian resident FIFs in which the trustee or a member of the trustee’s NZ Group has a direct income interest of 10% or more, for which no FIF income will arise due to the new exemption (proposed replacement for s. EX 35) for FIFs that are resident in Australia and subject to tax there.</u> • <u>All FIF interests for which the trust is able to use and uses, the new Attributed FIF Income (AFI) calculation method (proposed replacement for the Branch Equivalent (BE) method – see below) being a FIF interest that is:</u> <ul style="list-style-type: none"> ○ an income interest of 10% or more in a FIF that is a company; or ○ an income interest in a FIF that is a CFC, where the market value of the FIF at the beginning of the accounting period cannot be determined other than by an independent valuation (i.e. a FIF interest in a CFC whose shares are not widely traded). ○ <p>[Clause 46 of the Bill]</p>
(14) What is the special rule under which a CFC held by a trustee is included in an excess debt outbound company’s worldwide group?	<p>(14) If a trustee has:</p> <ul style="list-style-type: none"> • a 50% or more ownership interest in an excess debt outbound company that is a member of a worldwide group (Worldwide Group A); and • an income interest in a CFC that is not part of the Worldwide Group A, <p>the CFC is part of the Worldwide Group A.</p> <p>[s. FE 31C]</p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(15) How is the Worldwide Group debt percentage calculated?	<p>(15) The debt percentage of the trustee of an excess debt NZ trust's Worldwide Group is calculated using the method prescribed under GAAP for the consolidation of companies and the measurement rules set out in (8) on page 7.</p> <p>Commissioner can estimate debt percentage: If the trustee of an excess debt NZ trust is unable to calculate its Worldwide Group debt percentage for an income year, the Commissioner can be asked to estimate the percentage.</p> <p>Default debt percentage 68.1818%: The default Worldwide Group debt percentage of 68.1818% applies if the trustee is unable to calculate the percentage, and:</p> <ul style="list-style-type: none"> • does not ask the Commissioner to make an estimate; or • if asked, the Commissioner cannot reasonably estimate the debt percentage, <p>[s. FE 18]</p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
<p>(16) How is income calculated if the group debt % threshold is breached and the trustee does not choose the new threshold test? (i.e. the standard formula)</p>	<p>(16) If the trustee of an excess debt NZ trust does not choose the new threshold test, and the group debt percentage threshold amount (of 75% or 110% of the worldwide group debt percentage) is breached, the trustee has income equal to:</p> $(\text{total deduction} - \text{adjust}) \times \frac{\text{total debt} - \text{concession}}{\text{total debt}} \times \frac{\text{group debt \%} - \text{threshold amount}}{\text{group debt \%}}$ <p><u>Items in the formula:</u></p> <p><u>Total deduction:</u> is deductions allowed for interest payable by the trustee to persons who are not in the trustee's NZ Group, <u>excluding</u>:</p> <ul style="list-style-type: none"> • deductions for interest on financial arrangements that do not provide funds to the trustee; and • deductions for interest on financial arrangements that do provide funds to the trustee, where the interest deductions arose only from exchange rate movements. <p>[Note: total deduction = the trust's finance cost]</p> <p><u>Adjust:</u> is a figure determined by the <u>application of the exception referred to as "Exception 3" under the exceptions in (10) above, or the limited income exception in (11) above.</u> See (10) and (11) on pages 8-9 for the adjusted finance cost resulting from the application of these exceptions. It results in either a zero finance cost, so that there is no income, (if the exception in (10) applies) or a reduced finance cost for calculating income (if the limited income exception in (11) applies).</p> <p><u>Total debt:</u> is total debt as measured when calculating the group debt percentage (see (7) above on page 6), but before any reduction due to the on-lending concession in section FE 13.</p> <p><u>Concession:</u> is the reduction in total debt allowed under the on-lending concession in section FE 13 (see (9) above on page 7).</p> <p><u>Group debt percentage:</u> is the trustee's NZ Group debt percentage for the income year (see (7) above on page 6).</p> <p><u>Threshold amount:</u> is the greater of 75% or 110% of the trustee's Worldwide Group's debt percentage.</p> <p>[s. FE 6]</p>

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(17) What is the proposed new threshold test? From when can this test be used?	<p>(17) The proposed new threshold test is an alternative to the main test, and is available to the trustee of an excess debt NZ trust, <u>provided the eligibility criteria are met</u> (see below).</p> <p><u>Interest-income ratio:</u> This test involves calculating the trustee's NZ Group's <i>interest-income ratio</i> and comparing it to a set threshold, which is the lower of:</p> <ul style="list-style-type: none"> • 50% of the NZ group's ratio; or • 110% of the company's Worldwide Group interest-income ratio. <p><u>Ability to use the test:</u> In order to use this test, the trustee must:</p> <ul style="list-style-type: none"> • be <u>eligible</u> to use this test; and • <u>choose</u> to use this test <p>[Clause 47(1) of the Bill: proposed new s. FE 5(1B)(ab)]</p> <p><u>Application date:</u> The proposal is that this test will be able to be used for income years beginning on or after 1 July 2009.</p> <p>[Clauses 48(7), 48(2) & 49(2) of the Bill]</p>
(18) What are the eligibility requirements to use the new threshold test?	<p>(18) The requirements for eligibility are:</p> <ol style="list-style-type: none"> 1. The test is based on comparing interest deductions to <u>adjusted net profit (ANP)</u>, so the first requirement is that ANP (see (20) below) must be more than zero, for both the trustee's NZ Group and the trustee's Worldwide Group 2. Interest deductions allowed under sections DB 6 to DB 9 must exceed interest income for the trustee's NZ Group. 3. Interest deductions allowed under sections DB 6 to DB 9 must exceed interest income for the trustee's Worldwide Group (treating any non-resident members as NZ residents). 4. The total group debt of the trustee's Worldwide Group must be at least 75% of total group assets, not including goodwill. 5. At least 80% of the trustee's Worldwide Group's total group debt must have been borrowed from lenders who are not associated with the Group under subpart YB. <p>[Clause 47(3) of the Bill: proposed new s. FE 5(1BB)]</p>

**INTEREST APPORTIONMENT RULES
FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS**

(19) What is “Adjusted Net Profit”?

(19) Adjusted net profit (ANP), for each of: the trustee’s NZ Group and the trustee’s Worldwide Group, is:

[Group NPBT – attributed + net interest + depreciation + amortisation]

All of the amounts comprising ANP, apart from net interest, are calculated under GAAP, and are explained as follows:

Group NPBT: is Group net profit or loss before tax. (A loss is treated as a negative number.)

Attributed: consists of the income included in NPBT from the CFC and FIF holdings that caused the interest apportionment rules to apply [described in **s. FE (2)(1)(g)**].

For the Worldwide Group “attributed” will be zero.

Net interest: is:

- an add-back (to NPBT) of interest deductions, allowed under sections **DB 6 to DB 9**, from financial arrangements that provide funds to the Group; and
- a subtraction (From NPBT) of interest income from financial arrangements on arms length terms with borrowers who meet the requirements for the on-lending concession in **section FE 13(3)**.

For the Worldwide group “net interest” is calculated by treating any non-resident members as NZ residents.

Depreciation and amortisation: are add-backs of these amounts included as expenditure in the calculation of Group NPBT.

[Clause 47(3) of the Bill: proposed new ss. FE 5(1BC) & (1BD)]

Group calculations: The Group calculations must be performed using the GAAP rules for the consolidation of companies.

If a NZ Group member is not resident in NZ, amounts relating to that member are only included in the consolidation to the extent that:

- the non-resident member carries on business in NZ through a fixed establishment in NZ; or
- the non-resident member derives income from NZ, other than non-resident passive income, for which there is no treaty relief.

[Clause 49 of the Bill: proposed new section FE 12B]

Application date: As already noted, there is a retrospective application date for this calculation: income years beginning on or after 1 July 2009, except for the exclusion of non-resident passive income, for which the application date is income years beginning on or after 1 July 2011.

[Clauses 47(7), 49(2) & 49(3) of the Bill]

INTEREST APPORTIONMENT RULES FOR TRUSTEES OF EXCESS DEBT NZ TRUSTS	
(20) Exactly how is the threshold test performed?	<p>(20) The threshold test involves: calculating the <u>interest-income ratio</u> for the trustee of an excess debt NZ trust's NZ Group, and comparing it to a set percentage threshold. <u>If the interest-income ratio is higher than the threshold, the company will have income under a set formula.</u></p> <p>Interest-income ratio: The interest-income ratio is calculated for each of: the NZ Group and the Worldwide Group as follows:</p> $\text{Interest-income ratio} = \frac{\text{net interest}}{\text{Adjusted net profit}}$ <p>The items are the same as in the Adjusted Net Profit calculation in (19).</p> <p>Threshold ratio: The threshold interest-income ratio above which the trustee will have income is the <u>lower of</u>:</p> <ul style="list-style-type: none"> • 50% of the trustee's NZ Group's interest-income ratio; and • 110% of the trustee's Worldwide Group's interest-income ratio. <p>[Clause 47(5) of the Bill: proposed new ss. FE 5(1D), (1E) & (1F)]</p>
(21) How is income calculated if the threshold is breached?	<p>(21) If the threshold ratio is breached, the trustee of an excess debt NZ trust has income equal to:</p> $\text{Trustee's net interest} \times \frac{\text{NZ Group ratio} - \text{threshold ratio}}{\text{NZ Group ratio}}$ <p>Trustee's net interest is:</p> <ul style="list-style-type: none"> • the trustee's interest deductions, allowed under sections DB 6 to DB 9, from financial arrangements that provide funds to the trustee; <u>less</u> • the trustee's interest income from financial arrangements on arms length terms with borrowers who meet the requirements for the on-lending concession in section FE 13(3) (see (9) on page 7 above). <p>[Clause 48 of the Bill: proposed new s. FE 6B]</p>
(21) What are the compliance requirements for using the new threshold test?	<p>(22) By the time its tax return for the year is due to be filed, the trustee of an excess debt NZ trust that uses the new threshold test, must provide the following information (in the form and the means prescribed) to the Commissioner:</p> <ul style="list-style-type: none"> • Notice to the Commissioner that section FE 6B has been applied. • A reconciliation of Adjusted Net Profit calculated under section FE 5(1BC) to GAAP net profit. • A reconciliation of goodwill to items presented in the GAAP balance sheet. • Any further information that is required by the Commissioner. <p>[Clause 136 of the Bill: proposed new s. 65B of the Tax Administration Act 1994 to apply to income years beginning on or after 1 July 2009]</p>