



Submission to the

Finance and Expenditure Committee

on the

**Taxation (International Investment and Remedial
Matters) Bill:**

**Proposed Exemption: Zero Rate of Approved
Issuer Levy on Qualifying Bonds (s86IB)**

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EXECUTIVE SUMMARY

1. The New Zealand Bankers' Association (NZBA) appreciates this opportunity to submit on the Taxation (International Investment and Remedial Matters) Bill (the Bill). We would welcome the opportunity to make an oral submission to the Finance and Expenditure Committee.
2. NZBA supports the introduction of an exemption from the approved issuer levy (AIL) for qualifying bonds. However, we submit that the current exemption proposed in s861B is too narrow.
3. AIL adds uncertainty, complexity and cost to international investors looking to invest in domestic (NZD) debt issues. This in turn reduces participation and development of New Zealand Debt markets, and increases the reliance of corporate New Zealand on bank funding or offshore markets.
4. It does not contribute to the Government's overall objective of deepening New Zealand's capital markets, and, specifically, of strengthening the domestic corporate bond market.
5. The proposed exemption should be drafted in such a way to provide certainty to investors, and to encourage diversification of New Zealand companies' ability to directly source offshore funds. It should also be consistent with the Australian tax system, so international investment into Australian markets is not favoured.
6. The proposed exemption requires the issue to be **held by 100 or more investors and be offered to the public**. NZBA recommends the widely held test is removed and the criterion for the s861B exemption is aligned with those in section 128F of the Australian Income Tax Assessment Act. That is, the test should be satisfied if the issue is **offered to ten or more institutional investors, or at least 100 persons** whom it was reasonable for the company to regard as either having acquired debentures or debt interests in the past or as being likely to be interested in acquiring debentures or debt interests. Investors could be guaranteed that this will occur. This guarantee would not exist under the widely held test.
7. NZBA acknowledges the concern of officials around protecting the New Zealand tax base. However, any concerns can be addressed by specific exclusions targeting those areas of concern e.g. debt issued to associates and closely held debt. NZBA is prepared to assist officials in working through and addressing these concerns. Further, the objectives of creating certainty, and encouraging New Zealand companies to participate, in the New Zealand Debt market, and reducing reliance on bank funding, should prevail.

ABOUT NZBA

8. Established in 1891, the New Zealand Bankers' Association is a non-profit unincorporated association funded by member banks. In conjunction with its members, NZBA develops and promotes the banking industry viewpoint in policy discussions and in the media. NZBA also facilitates good practices in the banking industry.
9. NZBA works with its members on a consensus basis to provide a range of services including:
 - Collective submissions on public policy and regulation which affect banks in relation to, for example, taxation, consumer credit, privacy, terrorism and money laundering
 - Development of the self-regulatory Code of Banking Practice
 - Communication on non-competitive industry issues.
10. Membership of NZBA is open to any bank registered under the Reserve Bank of New Zealand Act 1989. Currently twelve registered banks are members of the NZBA. Our members are:
 - ANZ National Bank Limited
 - ASB Bank Limited
 - Bank of New Zealand
 - Bank of Tokyo-Mitsubishi, UFJ
 - Citibank, N.A.
 - Hongkong and Shanghai Banking Corporation Limited
 - JPMorgan Chase Bank, N.A.
 - Kiwibank Limited
 - Rabobank New Zealand Limited
 - Southland Building Society
 - TSB Bank Limited
 - Westpac New Zealand Limited.

BACKGROUND

11. In October 2008 NZBA submitted to officials a case for the introduction of an exemption from NRWT/AIL along the lines of that in place in Australia. The rationale for the suggested reform was the pressure at that time on New Zealand banks sourcing offshore funds and the impact of that pressure on New Zealand borrowers.
12. The submission noted that:
 - a. Some traditional sources of funding had tightened significantly;

- b. Banks had to therefore diversify into non traditional markets;
 - c. New Zealand banks faced a premium of 35 to 40 basis points relative to their Australian parents;
 - d. Existing branch structures were not attractive to non traditional markets;
 - e. Banks incurring AIL were passing that cost on to their New Zealand borrowers.
13. The severity of some of the above factors was exacerbated by the global financial crisis. While in the interim period some of these pressures have eased, AIL continues to have a negative impact on the choices available to banks when raising funds offshore.
14. The imposition of AIL on corporate debt issues has an indirect impact on bank funding requirements. AIL acts as an added complexity and cost to international investors looking to invest in domestic (NZD) debt issues. This reduces participation and development of New Zealand Debt markets and increases the reliance of corporate New Zealand on bank funding or offshore markets. Policy settings should facilitate diversification of New Zealand companies' ability to directly source offshore funds.

CONFLICT WITH POLICY SETTINGS SEEKING DIVERSIFICATION IN OFFSHORE FUNDING

15. The global economic crisis highlighted New Zealand's reliance on offshore funding, particularly from traditional sources. One consequence of this is the Reserve Bank's current focus on encouraging diversification in New Zealand's offshore funding. The Reserve Bank's focus is three-fold:
- a. It seeks diversification in the source of funds with a move towards achieving a balance of funds from both traditional and non traditional markets (e.g. Japan and other Asian countries);
 - b. It seeks diversification in the type of funding secured with a desire for more variety in the terms and types of instruments issued offshore;
 - c. It seeks diversification of the New Zealand companies who have ability to directly source offshore funds.
16. However, a significant factor impeding the diversification sought by the Reserve Bank is the imposition of AIL on offshore borrowing.

17. The AIL exemption proposed in s86IB is restricting, for the reasons outlined below:

- a. Section 86IB(1)(b)(i) requires that in order to attain a zero rate of AIL, the issue of the security must be **to the public**, for the purposes of the Securities Act 1978. This clause effectively limits the AIL exemption to retail bond issues. However, retail issues are considerably more onerous in terms of documentation costs and the time required preparing them. Selling restrictions around retail issues also mean that it is difficult for international investors to participate in primary issuance.
- b. Section 86IB2(b) and (c) require that the group of persons who each **hold** a security included in the class of securities consists of 100 or more non-associated persons. This would have very limited application, and therefore very limited benefit for bond issuances by any New Zealand businesses, including the banks. It is unusual for a wholesale New Zealand bond issue to be held by 100 or more investors. A typical wholesale bond issuance in the New Zealand bond market generally involves the issue of bonds to 10-15 investors and it is not uncommon to have less than 10 investors. This observation applies to both corporates and banks.

18. The fact that Member banks cannot advise Institutional investors whether the issue will be held by 100 or more investors means there is no certainty in the market as to whether AIL will apply. Contrarily, the Australian public offer test allows for certainty, because the bond issuance would prima facie have satisfied the Australian public offer test as the bonds were offered to at least 100 investors or 10 or more institutional investors.

19. If the exemption is enacted as proposed in the Bill, it will create a clear incentive for the Australian owned banks to debt-fund out of Australia, and to use the resulting funds in Australia. There would be a two-tiered market.

RECOMMENDED AMENDMENTS TO s86IB

20. The exemption would be significantly improved if the criteria for the exemption were aligned with the Australian test contained in section 128F of the Australian Income Tax Assessment Act 1936.

21. The Australian test applies to bonds **offered** to ten or more institutional investors, or at least 100 persons whom it was reasonable for the company to regard as either having acquired debentures or debt interests in the past or as being likely to be interested in acquiring debentures or debt interests.

22. This would create certainty for potential investors, it would be far less confusing to them, and would apply to a wider range of New Zealand businesses. This would in turn increase the size and liquidity of New Zealand's domestic bond market. It would also further harmonise New Zealand's and Australia's tax rules.
23. Australia also specifically includes within the exemption:
- a. Debt offered as a result of negotiations being initiated publicly in electronic form, or in another form, that is used by financial markets for dealing in debentures or debt interests;
 - b. Debt offered to a dealer, manager or underwriter in relation to the placement of debentures or debt interests, who, in an agreement with the company, offers the debentures or debt interests for sale within 30 days in a way covered by one of the other tests.
 - c. The issue of a global bond i.e. a single instrument that evidences the total amount owing by the issuing company with individual investors holding a percentage interest in the bond.
 - d. Debentures or debt interests issued by certain public bodies as if the body were an Australian resident company provided the debenture or debt interest is issued outside Australia.
 - e. Debentures or debt interests issued through a non-resident borrowing subsidiary. The subsidiary must be resident in the country of issue (which must be a country specified in the regulations) and the sole business of the subsidiary must be the raising of finance for the parent company.
24. The above categories are logical in policy-terms and cater for commercial circumstances that are equally relevant in New Zealand. Their adoption would ensure that the proposed exemption is aligned with commercial reality thus increasing the prospect of it achieving its purpose.
25. Australian bond issuance by year has increased by 37 per cent on average from 2004 to 2009 (Bloomberg) versus Funds under management growth of 12.8 per cent (Australian Bureau of Statistics).
26. This divergence between debt market growth and local investment capacity is made possible by offshore investment. The experience of one Member bank which is a lead manager in Australian transactions, is that like Australian dollar issues by non-Australian issuers (i.e. Kangaroos), typically more than 25 per cent of domestic issuer transactions are going to offshore investors. It is not uncommon for tranches to reach 40 per cent offshore placement.

27. We acknowledge the concern of officials around protecting the New Zealand tax base. However, any concerns can be addressed by specific exclusions targeting those areas of concern e.g. debt issued to associates and closely held debt. NZBA is prepared to assist officials in working through and addressing these concerns.
28. If the proposed widely held test is retained, the test should at a minimum be improved by:
- a. Decreasing the number of investors that are required to hold the bonds to a more realistic number. As discussed above, most bond issuances are to 10 to 15 investors. By decreasing the number of holders more businesses will be able to avail themselves of the exemption thus increasing its effectiveness in promoting the development of a corporate bond market in New Zealand.
 - b. Ensuring the widely held test applies on a programme basis rather than on a tranche by tranche basis. It is common practice for bonds to be issued on a tranche by tranche basis while still forming part of the overall programme. The application of the widely held test would be extended if this practice were recognised. This would also be of equal application if the Australian test outlined above were adopted.
 - c. Reconsideration of some of the specific exclusions. Currently the proposal includes specific exclusions for bonds issued through a private placement to a select group of investors, for bonds not openly advertised to the target market during the book build process and for bonds that are an 'asset-backed' security. NZBA considers it is important to ensure the exclusions are tightly framed to address the key concern i.e. associate or closely held debt, without making them so wide as to render the exemption redundant. For example the exclusion of all bonds issued through private placements or not openly advertised is too wide. The use of private placements is common but does not necessarily mean the bonds are closely held, particularly if all the other qualifying criteria are met.