20 June 2012

Tony Sadler
HM Revenue and Customs
Room 3c03,
100 Parliament Street
LONDON
SW1A 2BQ

by post & email

Dear Tony

Response to the Consultation on "Possible changes to income tax rules on interest"

This letter represents the views of the New Zealand Bankers' Association ("the NZBA"). The NZBA is the New Zealand banking industry group, established to represent and promote policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

The NZBA is concerned that the proposals relating to Yearly Interest and Quoted Eurobonds in their current form will undermine the efficiency of the funding operations that New Zealand Banks have established in the United Kingdom (the "UK"). This will in effect increase the cost of funds to the New Zealand economy obtained through the UK funding operations. Ultimately, the imposition of such a cost will either be passed into the New Zealand banking system or, more likely, require consideration of the UK funding operations to be relocated outside the UK.

The issue is that New Zealand is a net capital importer and the New Zealand Banks operate to largely intermediate the supply of funds to the New Zealand economy. As part of this, currently, the major New Zealand Banks utilise their UK funding operations to access the Euro and US debt capital markets, with all of the proceeds then being on lent back to New Zealand.

To date, the UK has been a successful locale from which to base such operations. At a broad summary level, these operations involve the UK branch of a subsidiary of a New Zealand incorporated and registered Bank sourcing funds, usually through the issuance of short-term commercial paper and medium-term notes from the Euro and US markets and on-lending those funds (at a margin) to its New Zealand parent bank. The margin from these activities (which has been agreed with HMRC) is subject to tax in the UK.

Both the short interest exemption and quoted Eurobond exemption are utilised in these structures to ensure that the interest paid by the UK funding operation to the market is able to be paid gross of any tax. The New Zealand Bank's UK branches do not satisfy the definition of a "bank" in the UK Tax legislation (as not subject to Financial Services Authority

regulatory requirements) and therefore are unable to rely on the bank exemption from UK interest withholding tax. If a withholding tax liability were to be imposed, then this would be to the cost of the UK branch (refer further below), which in effect would reduce the effectiveness of the UK funding operations. The imposition of such a withholding tax liability would, therefore, require a reassessment of the ongoing commercial viability of locating these funding operations in the UK.

Given that New Zealand banks have chosen to use the UK (rather than other possible jurisdictions) as the location for this activity and UK tax is being paid at the branch level, we do not consider that reform in this area is required.

We comment briefly below on the impact of the relevant proposals on these funding structures.

Short Interest

A significant portion of the funding obtained through the UK funding operations is short term commercial paper raised from both the Euro and US markets. (Short term commercial paper programmes provide access to a different series of investors, thus providing different funding opportunities to be explored.) The current short interest treatment is relied upon to allow gross payment of interest on such instruments. If a withholding or tax would be imposed on such interest flows, then the funding programmes require the issuer (borrower) to gross up the interest payment for that tax impost. Removal of the short interest exemption would therefore impose a (tax) cost on the UK branches which would reduce the effectiveness of the UK funding operations.

While it might, in theory, be possible to list such programmes so as to utilise the listed Eurobond exemption, such would impose a significant compliance burden on the UK operations. Ease of business operation, including the impact of regulatory compliance cost, was a factor in the selection of the UK as the funding hub. Imposing a compliance cost in these circumstances would run counter to this and, again, may require reassessment of locating funding operations in the UK.

Further, from time to time, short term funding may be required to be obtained by the UK Branch from related parties and on-lent in the model described above. This typically occurs when market conditions are not favourable to fund raising but excess funds exist elsewhere in the group (for example, during the global financial crisis GFC) when the markets became illiquid). As is detailed below, the proposals in respect of the Quoted Eurobond exemption could prevent this exemption applying in any case.

Quoted Eurobond Exemption

For funding other than short term commercial paper, the Quoted Eurobond exemption is typically relied upon to make interest payments free of any withholding tax. As with the short term commercial paper programmes, where a withholding or tax would be imposed on such interest flows, then the funding programmes will require that the issuer grosses up the interest payment for that tax impost.

While most of the holders of such notes are typically unrelated parties, from time to time a related party may hold such a note. Such instances are not the norm and would typically only occur in instances of market dislocation or where the market funding is not otherwise able to be accessed at acceptable rates. We further note that in such cases, the related party is typically a UK based entity or subject to tax in a comparably taxed jurisdiction. Such

funding does not, therefore, involve the “mischief” seemingly aimed at and accordingly, we would be concerned if actions to combat such “mischief” inadvertently prevented related party funding in the circumstances outlined above.

Finally, we note that a “regularly” traded test would not be viable in the case of issuance to unrelated parties. This is because a large proportion of funding of this nature is illiquid (as akin to a private placement) so that the notes are typically held on a long term basis.

Grandfathering

Further to the discussion above we do not believe such changes to the Short Interest or Quoted Eurobond exemptions are required. However, if such changes were made we believe that the grandfathering of existing positions is justified given that such transactions were undertaken based upon the then applicable regimes.

We trust that the above is helpful in outlining our concerns on this matter. We would welcome your consideration of our concerns and would be happy to discuss the matter further with you.

Yours sincerely

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Regulatory Director

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