INTEREST APPORTIONMENT RULES FOR EXCESS DEBT OUTBOUND COMPANIES

Including the Taxation (International Investment and Remedial Matters) Act 2012 amendments

CONTENTS: (Page 1 of 2) **Page Nos.**

Section I: When the rules apply from and which companies they apply to

(1) When do the rules apply from? 3

(2) Which companies do the rules apply to? 3

Section II: The debt percentage threshold

(1) What is the debt percentage threshold over which income will result? 4

Section III: The NZ group

(1) The NZ group 5

(2) Identifying the NZ parent 5

(3) Establishing companies under the NZ parent's control 5

(4) Identifying the members of the NZ group 6

Section IV: The group debt percentage

(1) How the group debt percentage is calculated 7

(2) How debts and assets are determined 7

(3) How group debts and assets are determined 8

(4) The measurement rules 8

(5) Financial arrangements that can be excluded under the on-lending concession 9

Section V: The exceptions

(1) When there is no income even when the debt % threshold is breached: 1 & 2 10

(2) When there is no income even when the debt % threshold is breached: 3 11

(3) When there is limited income if the debt % threshold is breached 12

Section VI: The worldwide group

(1) When it is necessary to establish the worldwide group's members 13

(2) The members of the worldwide group 13

(3) How the worldwide group's debt percentage is calculated 14

Section VII: Income under the standard formula

(1) How income is calculated under the standard formula 15

(2) Transferring income to another group company with interest deductions 16

...continued on page 2

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INTEREST APPORTIONMENT FOR EXCESS DEBT OUTBOUND COMPANIES

CONTENTS: (Page 2 of 2) **Page Nos.**

Section VIII: The new threshold test

(1) The proposed new threshold test and from when can it be used? 17

(2) The eligibility requirements to use the new threshold test? 17

(3) Adjusted net profit 18

(4) Calculation of interest-income ratio and comparison to threshold ratio 19

(5) How income is calculated if the threshold is breached 19

(6) The compliance requirements for using the new threshold test 20

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INTEREST APPORTIONMENT RULES FOR EXCESS DEBT OUTBOUND COMPANIES

SECTION I: WHEN THE RULES APPLY FROM AND WHICH COMPANIES THEY APPLY TO

<table>
<tr><td>(1) When the rules apply from</td><td>The rules apply to income years beginning on or after 1 July 2009.

The amendments contained in the Taxation (International Investment and Remedial Matters) Act 2012 apply to income years beginning on or after 1 July 2011 (unless otherwise specified).</td></tr>
<tr><td>(2) Which companies the rules apply to
(Note: only the application to companies is considered in this document.)</td><td>The rules apply to an <u>excess debt outbound company</u> which is:

(a) <u>A NZ resident company with an income interest in a CFC</u>, which can be:
(i) A NZ resident company with an income interest in a CFC; or
(ii) 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.

(b) <u>A NZ resident company that satisfies the requirements of s. EX 35</u>, which is:
(i) A NZ resident company with a direct income interest of 10% or more in an Australian resident FIF, for which no FIF income will arise due to the new exemption in 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); or
(ii) A NZ resident (parent) company with an ownership interest of 50% or more in, or control by any other means of, a company described in (i) above.

(c) <u>A NZ resident company with an interest if a FIF for which it uses the AFI method</u>:
(i) A NZ resident company that is able to use (this excludes listed companies, PIEs, unit trusts, super schemes and GIFs) and uses, the new Attributed FIF Income (AFI) calculation method (which replaces the Branch Equivalent (BE) method – see below) for a FIF interest that is:
a. An income interest of 10% or more in a FIF that is a company; or
b. 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).
(ii) 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.

[s. FE 2(1)(e) as amended by s. 51(1) of the Taxation (International Investment and Remedial Matters) Act 2012 & s. FE 2(1)(f)]

<u>AFI Method:</u> The AFI method in s. 35 of Taxation (International Investment and Remedial Matters) Act 2012is 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.</td></tr>
</table>

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SECTION II: THE DEBT PERCENTAGE THRESHOLD

(1) The debt % threshold above which income will arise under the interest apportionment rules	An excess debt outbound company must calculate income arising under the interest apportionment rules if: (a) The NZ Group Debt percentage is more than 75%; and (b) The NZ Group Debt Percentage is more than 110% of the Worldwide Group Debt Percentage. [s. **FE 5(1)(b)**] (See **Section IV** on **pages 7-9** for how the group debt percentage is calculated)

SECTION III: THE NZ GROUP

(1) The NZ Group	The NZ Group of an excess debt outbound company is determined as follows: (a) The "NZ Parent" must first be identified, as set out in s. **FE 26.** (b) The companies under the NZ parent's control must then be ascertained, as set out in s. **FE 27**. (c) The members of the NZ Group must then be identified, as set out in s. **FE 28.** [**ss. FE 12(4) & FE 25**]
(2) Identifying the NZ Parent	The steps to determine the NZ Parent of an excess debt outbound company ("the company") are as follows: (a) The company itself is the NZ Parent if no single NZ resident company has an ownership interest in the company of at least 50%. (b) If there is a NZ resident company ("Company C") that has an ownership interest in the company of at least 50%, Company C is the NZ Parent, unless there is another NZ resident company that has both an ownership interest in the company of at least 50%, and a direct ownership interest in Company C. (c) If there is another NZ resident company ("Company D") that has both an ownership interest in the company of at least 50%, and a direct ownership interest in Company C, Company D is the NZ Parent. (d) If there is no company that meets any of the above criteria, the company itself is treated as the NZ Parent. **Note:** Ownership interests of associated persons are ignored when identifying the NZ Parent. [**s. FE 26**]
(3) Establishing companies under the NZ Parent's control	The NZ Parent of an excess debt outbound company may choose as the <u>control threshold</u>: (a) More than 50%; or (b) 66% or more. In each case, the companies under the control of the NZ Parent are those in which direct ownership interests, of "more than 50% " or "66% or more" (depending on the chosen control threshold), are held collectively by the NZ parent and any other company included in the NZ Group. **<u>Default threshold:</u>** If the NZ Parent does not choose a control threshold, the "66% or more" threshold is used. **[s. FE 27]**

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<table>
<tr>
<td>(4) Identifying the members of the NZ Group</td>
<td>
The NZ Group of an excess debt outbound company is made up of:
(a) The excess debt outbound company; and
(b) Its NZ Parent; and
(c) Any other company that is under the NZ Parent's control; and
(d) Any company (other than a member of a NZ banking group of a registered bank) that:
(i) Is a NZ resident; or
(ii) Carries on business in NZ through a fixed establishment in NZ; or
(iii) Derives income sourced in NZ (<u>other than non-resident passive income</u>) for which there is no treaty relief;

[s. FE 28(1) <u>including the amendment</u> in s. 61 of the Taxation (International Investment and Remedial Matters) Act 2012 applying to income years commencing beginning on or after 1 July 2011]

<u>Ownership interest by group member:</u> If an excess debt outbound company is not identified as being under the NZ Parent's control under s. FE 27, but fits any of the above requirements, it is nevertheless included in the NZ Parent's NZ Group if any group member has a 50% or more ownership interest in it.

[s. FE 28(3)]
</td>
</tr>
</table>

SECTION IV: THE GROUP DEBT PERCENTAGE

(1) How the group debt percentage is calculated	The group debt percentage for an excess debt outbound company's NZ Group, and an excess debt outbound company's Worldwide Group is: $$\frac{\textbf{Debts}}{\textbf{Assets}}$$ [**s. FE 12**]
(2) How debts and assets are determined	**Debts are:** (see **Section IV (4)** on **page 8** 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; and (b) Fixed-rate foreign equity or fixed-rate shares issued by the company or another NZ Group member, and held by NZ residents; and (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; but (d) Excluding amounts on-lent that meet the requirements of s. **FE 13(3)** (the on-lending concession - see **Section IV (5)** on **page 9**. [**ss. FE 15 & FE 13**] **Assets are:** (a) Assets measured under GAAP, using the measurement rules (see **page x**) valued as follows: (i) As valued in the financial statements of the NZ Group; or (ii) At their net current values; or (iii) Valued at a combination of the above if allowed under GAAP. (iv) Valuation exceptions: a. Trading stock can be valued at market value if that is the tax value. b. Personal property lease assets, under a specified or finance lease, that are not recognized under GAAP can be valued at their adjusted tax values. (b) An investment in a CFC held by any NZ Group member or an investment of at least 10% in a FIF meeting the requirements of s. **EX 35** (Australian resident 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. (c) Assets exclude amounts on-lent that meet the requirements of s. **FE 13(3)** (the on-lending concession - see **Section IV (5)** on **page 9**. [**s. FE 16** as amended by s. **58** of the *Taxation (International Investment and Remedial Matters) Act 2012* – amendment applies to income years beginning on or after 1 July 2011, **& s. FE 13**]

SECTION IV: THE GROUP DEBT PERCENTAGE (continued)

<table>
<tr><td>(3) How group debts and assets are determined</td><td><u>Group debts and assets:</u> (using the measurement rules in (4) below) are:
(a) Debts and assets of the NZ group consolidated, to calculate the group debt percentage, using GAAP for the consolidation of companies.
(b) Debt and assets of a non-resident group member are included in the consolidation only to the extent that:
(i) A business is carried on in NZ through a fixed establishment in NZ; or
(ii) Income (<u>other than non-resident passive income</u>) is derived from NZ for which there is no treaty relief.

[s. FE 14(1) & (3) <u>as amended by</u> s. 58 of the Taxation (International Investment and Remedial Matters) Act 2012 - amendment applies to income years beginning on or after 1 July 2011]</td></tr>
<tr><td>(4) Measurement rules</td><td>1. <u>Measurement dates:</u> The total group debts and total group assets for an income year must be measured using 1 of the following methods:
(a) The average amount at the end of each day of the income year; or
(b) The average amount at the end of each quarter in the income year; or
(c) The amount at the end of the income year.

[s. FE 8]

2. 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.

[s. FE 9]

3. <u>NZ currency:</u> 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:
(a) The close of trading spot exchange rate for the foreign currency on the relevant measurement date; or
(b) The forward exchange rate on the 1st day of the income year for the relevant measurement date.

[s. FE 10]

4. <u>Anti-avoidance:</u> 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.

[s. FE 11]</td></tr>
</table>

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SECTION IV: THE GROUP DEBT PERCENTAGE (continued)

(5) Financial arrangements that can be excluded from debt and assets under the on-lending concession in section FE 13	The outstanding balance of a financial arrangement, that would otherwise be included in an excess debt outbound company's group debt and assets, can be excluded if the financial arrangement provides funds, for an arms length consideration, to another person who: (a) Is a non-resident, who (i) Does not carry on business through a fixed establishment in NZ; or (ii) Derives only non-resident passive income, or NZ sourced income that is completely relieved of NZ tax under a treaty (b) Is not associated with the company. (c) Is associated with the company, but: (i) Is not a member of the company's NZ Group; and (ii) Is a person subject to the interest apportionment rules. **Worldwide group on-lending concession:** When calculating the Worldwide Group's debt percentage, financial arrangements can be excluded under s. **FE 13** if, the person to whom funds are provided is not associated with the excess debt outbound company. **[s. FE 13** as amended by s. **56** of the *Taxation (International Investment and Remedial Matters) Act 2012* - amendment applies to income years beginning on or after 1 July 2011**]**

SECTION V: THE EXCEPTIONS

(1) Exceptions where there is no income even when the debt % threshold is breached: Exceptions 1 & 2	There are **3 exceptions** under which an excess debt outbound company ('the company") will not have any interest apportionment income even if the debt percentage threshold is breached. 1. **Exception 1:** Where the company'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. [**s. FE 5(1B)(a)**] 2. **Old Exception 2:** Where: (a) The company's NZ Group's deductions for interest paid to lenders outside the Group does not exceed $250,000; and (b) The company'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. [**Old s. FE 5(1B)(b)** - this exception has been repealed by s. **53(2)** of the *Taxation (International Investment and Remedial Matters) Act 2012* and will not be available from income years beginning on or after 1 July 2011. **New (replacement) Exception 2:** Clause 47(1) - (4) of the Bill contains a proposal to replace this exception with the following: Where the company is eligible to use, and chooses to use, the proposed new threshold test, (see **(x) to (x)** below) and under that test, the company's NZ Group's *interest-income ratio* (see **(x) and (x)** below) does not exceed*:* (a) 50%; and (b) 110% of the company's Worldwide Group's interest-income ratio. This replacement exception is available as an alternative to the replaced exception for income years beginning between 1 July 2009 and 30 June 2011. This new (replaced) exception applies exclusively in income years beginning on or after 1 July 2011. [**New ss. FE 5(1B)(ab) & FE 5(1BB) to FE 5(1F)** inserted by s. **53** of the *Taxation (International Investment and Remedial Matters) Act 2012* applying retrospectively to income years beginning on or after 1 July 2009]

<table>
<tr>
<td>(2) Exceptions where there is no income even when the debt % threshold is breached: Exception 3</td>
<td>
3. <u>Exception 3:</u>
(a) Where the <u>company's finance cost</u> is not more than $1,000,000, if the tax return was filed before 20 June 2011 relying on old s. FE 6(3)(ac)(ii) before its amendment; or
(b) Where the <u>company's NZ Group finance cost</u> is not more than $1,000,000, if the tax return was filed on or after 20 June 2011.

[s. FE 6(3)(ac)(ii) as amended by s. 45 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]

<u>Company's finance cost:</u> An excess debt outbound company's "company's finance cost" is the sum of:
(a) Deductions for interest payable by the company to persons who are not in the company's NZ Group.
(b) Dividends paid on fixed-rate foreign equity and fixed-rate shares (as defined – see below), issued by the company and held by NZ residents who are not in the company's NZ Group.
(c) Interest (treated as a dividend under section FA 2B) paid on stapled debt securities if, together with the shares they are stapled to, they meet the definition of fixed-rate foreign equity or fixed-rate shares, and they have been issued by the company and are held by NZ residents who are not in the company's NZ Group.
<u>Company's finance cost does not include:</u>
(d) Deductions for interest on financial arrangements that do not provide funds to the company.
(e) Deductions for interest on financial arrangements that do provide funds to the company, where the interest deductions arose only from exchange rate movements.

[ss. FE 6(2)&(3) & FA 2B]

<u>Company's NZ group finance cost:</u> The company's NZ group finance cost is the total of each Group member's company's finance cost.

<u>Note: Extended definition of 'fixed-rate share':</u> The extended definition of "fixed-rate share" in section YA 1 applies for the purposes of subpart FE (the interest apportionment for thin capitalisation rules) from income years beginning on or after 1 July 2009.

[s. YA 1 definition of "fixed rate share as amended by s. 130(6) of the Taxation (Administration and Remedial Matters) Act 2011]
</td>
</tr>
</table>

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SECTION V: THE EXCEPTIONS (continued)

<table>
<tr>
<td>(3) The exception under which limited income arises if the debt % threshold is breached</td>
<td>If the company'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.

(a) <u>For returns filed before 20 June 2011 relying on s. FE 6(3)(ac)(iii) before its amendment:</u>

The company's adjusted finance cost, for the purpose of calculating income, is:

$$\left[\textbf{Company's finance cost}\right] - \left[\textbf{\$2,000,000 - company's financecost}\right]$$

[s. FE 6(3)(ac)(iii) before amendment]

(b) <u>For returns filed on or after 20 June 2011:</u>

The company's adjusted finance cost, for the purpose of calculating income, is:

$$\left[\textbf{Company's finance cost}\right] - \left[\left(\textbf{\$2m - NZ Group finance cost}\right) \textbf{ x } \frac{\left(\textbf{company's finance cost}\right)}{\left(\textbf{NZ Group finance cost}\right)}\right]$$

[s. FE 6(3)(ac)(ii) as amended by s. 45 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]</td>
</tr>
</table>

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SECTION VI: THE WORLDWIDE GROUP

<table>
<tr><td>(1) When it is necessary to establish the Worldwide Group's members</td><td>If the debt percentage of an excess debt outbound company's NZ Group is more than 75%, the company must calculate the debt percentage of its Worldwide Group.

[s. FE 12(2)]

If the proposed new threshold test in new s. FE 6B is to be chosen, the company'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 (x) to (x) below).</td></tr>
<tr><td>(2) The members of the Worldwide Group</td><td>1. For an income year, <u>the Worldwide Group</u> of an excess debt outbound company <u>consists of all of the following</u>:
(a) The company.
(b) The company's NZ Group for the income year.
(c) All non-residents who are required to be included with the company in consolidated financial statements under GAAP.

[ss. FE 12(5) & FE 31B]

2. <u>Inclusion of CFC owned by trustee or natural person:</u> A CFC that is owned by a trustee of a trust settled by a NZ resident, or by a natural person NZ resident, is part of an excess debt outbound company's Worldwide Group if the trustee or natural person has:
(a) A 50% or more ownership interest in the excess debt outbound company; and
(b) An income interest in the CFC.

[s. FE 31C]

3. <u>Exclusion of joint venture connected only through a joint venture company:</u> A joint venture may be excluded from the Worldwide Group of a joint venture company (JV Co) for an income year, if:
(a) JV Co is in an excess debt outbound company's Worldwide Group; and
(b) The shares in JV Co are held in equal shares (50/50) by 2 joint venturers, and as a result, both joint venturers are also part of the company's Worldwide Group; and
(c) Only one of the joint venturers (the "included" joint venturer) is actually part of the chain of ownership establishing the Worldwide Group; and
(d) The other joint venturer (the "excluded" joint venturer) is only included because of the 50% interest in JV Co.

[s. FE 32]</td></tr>
</table>

(3) How the Worldwide Group debt percentage calculated	1. The debt percentage of an excess debt outbound company's Worldwide Group is calculated under GAAP for the consolidation of companies using the measurement rules set out in **Section IV (4)** on **page 8**. 2. **Commissioner can estimate debt percentage:** If an excess debt outbound company is unable to calculate its Worldwide Group debt percentage for an income year, it may ask the Commissioner to estimate the percentage. 3. **Default debt percentage 68.1818%:** The default Worldwide Group debt percentage of **68.1818%** applies if the company is unable to calculate the percentage, and: (a) Does not ask the Commissioner to make an estimate; or (b) If asked, the Commissioner cannot reasonably estimate the debt percentage. [**s. FE 18**]

SECTION VII: INTEREST APPORTIONMENT INCOME UNDER THE STANDARD FORMULA

<table>
<tr>
<td>(1) How income is calculated under the standard formula if the group debt % threshold is breached (i.e. the company does not choose the new threshold test)</td>
<td>
If an excess debt outbound company 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 company has income equal to:
$$(\text{Total deduction + FRD - adjust}) \times \frac{\text{total debt - concession}}{\text{total debt}} \times \frac{\text{group debt \% - threshold amount}}{\text{group debt \%}}$$
<u>Total deduction:</u> Deductions allowed for interest payable by the company to persons who are not in the company's NZ Group, <u>excluding:</u>
(a) Deductions for interest on financial arrangements that do not provide funds to the company; and
(b) Deductions for interest that arose only from exchange rate movements on financial arrangements that do provide funds to the company.
<u>FRD:</u> The total amount of dividends paid on fixed-rate foreign equity and fixed-rate shares, issued by the company and held by NZ residents who are not in the company's NZ Group, <u>including:</u>
Interest (treated as a dividend under section FA 2B) paid on stapled debt securities if, together with the shares they are stapled to, the securities meet the definition of fixed rate foreign equity or fixed rate shares, and they have been issued by the company and are held by NZ residents who are not in the company's NZ Group.
[Note: total deduction + FRD = the company's finance cost]
<u>Adjust:</u> is a figure determined by the application of the exception referred to as "Exception 3" – see Section V (2) on page 11), or the limited income exception in Section V (3) on page 12 above:
(a) If "Exception 3" applies, the adjusted finance cost is zero, so there is no income under the interest apportionment rules.
(b) If the limited income exception applies, there will be a reduced finance cost and a correspondingly reduced level of income under the interest apportionment rules.
<u>Total debt:</u> is total debt as measured when calculating the group debt percentage (see Section IV (2) on page 7), but before any reduction due to the on-lending concession in s. FE 13 (see Section IV (5) on page 9).
<u>Concession:</u> is the reduction in total debt allowed under the on-lending concession in s. FE 13 (see Section IV (5) on page 9).
<u>Group debt percentage:</u> is the company's NZ Group debt percentage for the income year (see Section IV above on pages 7 - 9).
<u>Threshold amount:</u> is the greater of 75% or 110% of the company's Worldwide Group's debt percentage.
[s. FE 6]
</td>
</tr>
</table>

SECTION VII: INTEREST APPORTIONMENT INCOME UNDER THE STANDARD FORMULA (continued)

(2) Transferring income to another group company with interest deductions	An excess debt outbound company can transfer income arising under the interest apportionment calculation to another company that is in the same wholly owned group, providing that: (a) The other company has interest deductions; and (b) The income transferred does not exceed the interest deductions, or the reduced interest deductions (if some income has already been transferred to the company under this allowance) of the other company. This rule applies from the 2008-09 income year onwards. [**s. FE 6(4)&(5)** inserted by s. **45(3)** of the of the *Taxation (Tax Administration and Remedial Matters) Act 2011*]

SECTION VIII: THE NEW THRESHOLD TEST

<table>
<tr><td>(1) The proposed new threshold test and from when can this test be used</td><td>The proposed new threshold test is an alternative to the main test, and is available to an excess debt outbound company, provided the eligibility criteria are met (see below).

Interest-income ratio: This test involves calculating the company's NZ Group's interest-income ratio and comparing it to a set threshold, which is the lower of:
• 50% of the NZ group's ratio; or
• 110% of the company's Worldwide Group interest-income ratio.

Ability to use the test: In order to use this test, the company must:
• Be eligible to use this test; and
• Choose to use this test

[s. FE 5(1B)(ab) as inserted by s. 53(1) of the Taxation (International Investment and Remedial Matters) Act 2012]

Application date: This test can be used in income years beginning on or after 1 July 2009.

[s. 53(7) of the Taxation (International Investment and Remedial Matters) Act 2012]</td></tr>
<tr><td>(2) The eligibility requirements to use the new threshold test</td><td>The requirements for eligibility are:

1. The test is based on comparing interest deductions to adjusted net profit ("ANP"), so the first requirement is that ANP (see Section VIII (3) below) must be more than zero, for both the company's NZ Group and the company's Worldwide Group

2. Interest deductions allowed under sections DB 6 to DB 9 must exceed interest income for the company's NZ Group.

3. Interest deductions allowed under sections DB 6 to DB 9 must exceed interest income for the company's Worldwide Group (treating any non-resident members as NZ residents).

4. The total group debt of the company's Worldwide Group must be at least 75% of total group assets, not including goodwill.

5. At least 80% of the company's Worldwide Group's total group debt must have been borrowed from lenders who are not associated with the Group under subpart YB.

[s. FE 5(1BB) as inserted by s. 53(3) of the Taxation (International Investment and Remedial Matters) Act 2012]</td></tr>
</table>

(3) Adjusted Net Profit	Adjusted net profit ("ANP"), for each of: the company's NZ Group and the company'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: **<u>Group NPBT:</u>** (A loss is treated as a negative number.) $\left[\begin{array}{l}\textbf{Group net profit or (loss)}\\ \textbf{before tax using GAAP}\end{array}\right]$ **<u>Attributed:</u>** $\left[\begin{array}{l}\textbf{Attributed CFC and FIF income}\\ \textbf{included in NPBT}\end{array}\right]$ For the Worldwide Group "attributed" will be zero. **<u>Net interest:</u>** is: $\left[\begin{array}{l}\textbf{Interest deductions}\\ \textbf{allowed under ss.DB6-DB9}\\ \textbf{for financial arrangements}\\ \textbf{that provide funds}\\ \textbf{to the group}\end{array}\right] - \left[\begin{array}{l}\textbf{Interest income}\\ \textbf{from financial arrangements}\\ \textbf{on arm's length terms}\\ \textbf{with borrowers who meet the}\\ \textbf{on-lending requirements in s.FE13}\end{array}\right]$ For the Worldwide group "net interest" is calculated by treating any non-resident members as NZ residents. **<u>Depreciation and amortisation:</u>** $\left[\begin{array}{l}\textbf{Depreciation and}\\ \textbf{amortisation}\\ \textbf{included in NPBT}\end{array}\right]$ [**s. FE 5(1BC) & (1BD)** as inserted by s. **53(3)** of the *Taxation (International Investment and Remedial Matters) Act 2012*] **<u>Group calculations:</u>** The Group calculations must be performed under 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: (a) The non-resident member carries on business in NZ through a fixed establishment in NZ; or (b) The non-resident member derives income from NZ, (<u>from 1/7/11: other than non-resident passive income</u>), for which there is no treaty relief. [**s. FE 12B** as inserted by s. **55** of the *Taxation (International Investment and Remedial Matters) Act 2012*]

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SECTION VIII: THE NEW THRESHOLD TEST (continued)

<table>
<tr>
<td>(4) Calculation of interest-income ratio and comparison to threshold ratio</td>
<td>
The threshold test involves: calculating the interest-income ratio for an excess debt outbound company's NZ Group, and comparing it to a set threshold ratio. If the interest-income ratio is higher than the threshold, the company will have income under a set formula.

Interest-income ratio: The interest-income ratio is calculated for each of: the NZ Group and the Worldwide Group as follows:

$$\textbf{Interest-income ratio} = \frac{\textbf{Net interest}}{\textbf{Adjusted net profit}}$$

The items are the same as in the Adjusted Net Profit calculation in Section VIII (3).

Threshold ratio: The threshold interest-income ratio above which the company will have income is the lower of:
(a) 50% of the NZ Group's interest-income ratio; and
(b) 110% of the Worldwide Group's interest-income ratio.

[s. FE 5(1D), (1E) & (1F) as inserted by s. 53(5) of the Taxation (International Investment and Remedial Matters) Act 2012]
</td>
</tr>
<tr>
<td>(5) How income is calculated if the threshold is breached</td>
<td>
If the threshold ratio is breached, an excess debt outbound company has income equal to:

$$\textbf{Company's net interest} \times \frac{\textbf{NZ Group ratio - Threshold ratio}}{\textbf{NZ Group ratio}}$$

Company's net interest is:

$$\left[\begin{array}{l}\textbf{Company's interest deductions}\\ \textbf{allowed under ss.DB6-DB9}\\ \textbf{for financial arrangements}\\ \textbf{that provide funds}\\ \textbf{to the group}\end{array}\right] - \left[\begin{array}{l}\textbf{Company's interest income}\\ \textbf{from financial arrangements}\\ \textbf{on arm's length terms}\\ \textbf{with borrowers who meet the}\\ \textbf{on-lending requirements in s.FE13}\end{array}\right]$$

[s. FE 6B as inserted by s. 54 of the Taxation (International Investment and Remedial Matters) Act 2012]
</td>
</tr>
</table>

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(6) The compliance requirements for using the new threshold test	By the time its tax return for the year is due to be filed, an excess debt outbound company that uses the new threshold test, must provide the following information (in the form and the means prescribed) to the Commissioner: (a) Notice to the Commissioner that s. **FE 6B** has been applied. (b) A reconciliation of Adjusted Net Profit calculated under s. **FE 5(1BC)** to GAAP net profit. (c) A reconciliation of goodwill to items presented in the GAAP balance sheet. (d) Any further information that is required by the Commissioner. [**s. 65B** of the Tax Administration Act 1994 as inserted by s. **143** of the *Taxation (International Investment and Remedial Matters) Act 2012* applying for income years beginning on or after 1 July 2009]