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New Zealand's Restricted Transfer Pricing Rules

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New Zealand's tax legislation includes unique interest limitation rules which can restrict the deductible interest rate on inbound related party loans to New Zealand.

While New Zealand's tax legislation has codified the OECD Transfer Pricing Guidelines, these interest limitation rules sit alongside the transfer pricing rules and are more restrictive than the OECD Transfer Pricing Guidelines in respect of loans.

The interest limitation rules require a prescribed approach to be followed when evaluating the credit rating applied when pricing cross-border related party inbound debt and removing the interest rate impact of certain 'exotic features'. We refer to these rules as the "Restricted Transfer Pricing" or "RTP" rules.

Typically, the rules result in a lower interest rate being supportable for New Zealand tax purposes than under the arm's length principle, and often New Zealand taxpayers will have non-deductible interest.

An evaluation of the RTP rules needs to be formally documented whenever new loans subject to the rules are entered into.

Summary of the RTP rules

The RTP rules require taxpayers to step through several technical tests to determine the creditworthiness of the borrower and separately limit the debt features that can be considered for pricing purposes.

The key points considered in an analysis of the RTP rules are as follows:

Credit Rating

1. The rules apply to related party loans inbound to New Zealand.
2. Borrowers with related party debt of less than NZD 10 million can apply Inland Revenue's safe harbour interest rate. For a borrower with total related party debt of NZD 10 million or greater at any point in the income year, the RTP legislation must be applied.
3. Finance and insurance entities generally will be deemed to have the same credit rating as the highest indebted member of their global group.
4. For all other entities, there are four potential credit rating approaches which apply to specific fact patterns:
   a) Group approach: where the borrower has a single parent entity and, its thin capitalisation ratio is more than 40% or the lender's interest income is taxed at less than 15%, this approach applies. The borrower is considered to have a credit rating which is generally consistent with that of the highest indebted member of their global group.
   b) Restricted approach: where the borrower does not have a single parent entity and doesn't satisfy the tests in 4a) above, this approach applies. The borrower's credit rating is the greater of: (i) its standalone credit rating with certain adjustments to its financial position, and (ii) BBB-.
   c) Default approach: this approach applies where the tests in (a) or (b) are not triggered. The standard OECD arm's length approach is applied to determine the credit rating of the borrower.
   d) Optional approach: all entities can make an election to use a local published credit rating (if available) or the implied credit rating on significant local third-party senior debt, instead of applying the other approaches.

Loan Features

5. What Inland Revenue considers "exotic" features of a loan, include subordination, payment in kind, interest deferrals, and a tenor of more than 5 years. These are ignored when undertaking the interest rate analysis. The exception is where these features are found in a significant portion of the taxpayer's or its global group's third-party debt.

General

6. Where a related party loan is renewed, extended, or renegotiated, this triggers a new evaluation and analysis under the RTP rules.

If you need help in evaluating the RTP rules for your business, please contact one our KPMG New Zealand Transfer Pricing leaders below.

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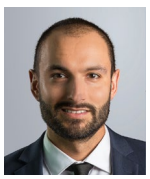

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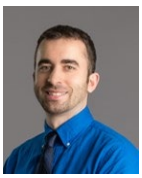

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