

## New Zealand Inland Revenue considers application of withholding tax rules to negative interest payments

Inland Revenue has recently released draft guidance concluding that negative interest on an advance of money or a loan will not be subject to New Zealand withholding tax. The draft guidance is timely as banks and financial institutions are considering the processes that would need to be put in place to allow for the payment of negative interest.

### Negative interest rates remain under consideration as a monetary policy measure

The Reserve Bank of New Zealand sets the Official Cash Rate (OCR) and historically the OCR has had a significant influence on market (including retail) interest rates. The OCR is currently 0.25%, the lowest it has been since its introduction in 1999. In light of the economic fallout from COVID-19, the Reserve Bank indicated on 11 November 2020 (when the OCR was last reviewed) that a "lower or negative OCR" remains under consideration, and that the "banking system is on track to be operationally ready for negative interest rates by year end".

### Inland Revenue concludes that a payment of negative interest is akin to a payment for holding money and is not interest for withholding tax purposes

Whether resident withholding tax or non-resident withholding tax will apply to negative interest turns on whether the negative interest amount is a payment of "interest" as defined. Domestic law generally defines "interest", for withholding tax purposes, as "a payment made to [a] person by another person for money lent to any person, whether or not the payment is periodical and however it is described or calculated", but excluding "a repayment of money lent". The obligation to withhold is generally triggered when interest is paid, although in some cases (involving related-party interest) withholding may be triggered on an accrual basis.

In its draft guidance, Inland Revenue confirms that the word "for" (in the context of the requirement that interest be a payment "for" money lent) "requires or implies the giving of interest in exchange – and countervailing with – the money lent...". As a payment of negative interest would be from the lender to the borrower, Inland Revenue concludes that such a payment would not be "for" money lent, but is more akin to a payment to the borrower for "receiving, acceptance or holding of the money".

Also of importance to banks and financial institutions is Inland Revenue's conclusion that the reporting requirements for interest do not apply to negative interest payments.

The conclusion Inland Revenue reaches in its draft guidance (as described above) is as expected, and appears to be consistent with the practice of other countries that have addressed the issue. Her Majesty's Revenue and Customs, for instance, has commented (in HMRC's Savings and Investment Manual, at SAIM2060) that negative interest "does not meet the definitions of interest" but is "akin to a fee paid to the debtor to hold the creditor's money".

Inland Revenue's draft guidance notes that "[n]egative interest payments will still be subject to income tax but there is no withholding requirement on such payment". This reflects the fact that the definition of interest referred to above applies for withholding tax purposes, whereas the question of whether an amount derived from or under a debt instrument or other financial arrangement is taxable is determined under New Zealand's financial arrangements rules.

The financial arrangements rules bring to tax, on an accrual basis, all income, gains, expenditure and losses arising from consideration payable for or under a financial arrangement, and with limited exceptions override the distinction between capital and revenue that otherwise applies under New Zealand's income tax law. Accordingly, a borrower receiving negative interest would generally be required to recognise such negative interest as income.

Submissions on the draft guidance close on 15 January 2021.

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