

New Zealand

Country M&A Team

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1. Introduction

1.1 General Information on M&A in New Zealand

This chapter outlines the key New Zealand tax issues that should be considered when buying or selling a business in New Zealand.

The New Zealand tax base is reasonably broad and includes, in addition to income tax, a flat rate consumption tax (goods and services tax) and a comprehensive international tax regime. New Zealand does not have a comprehensive capital gains tax but certain capital gains are taxed under different regimes.

A foreign investor tax credit regime allows a resident company's profits to be distributed to foreign investors without the economic cost of non resident withholding tax in certain circumstances. Conduit tax relief provisions (which are expected to be repealed from the start of the 2009/10 income year) provide tax relief for foreign investors making equity investments in a foreign company via a New Zealand company.

Recent and current reforms include significant changes to the rules governing the taxation of income from offshore equity investment (including the partial removal of the current 'grey list' concessions under the foreign investment fund regime), the introduction of an active income exemption for income derived through controlled foreign companies and new limited partnership rules.

Company and tax law allow companies to amalgamate. Amalgamation can be used as an alternative to a share purchase or as part of a post acquisition restructuring.

Companies are also able to migrate both into New Zealand and out of New Zealand.

New Zealand's tax legislation allows companies to carry forward (but not to carry back) losses subject to shareholder continuity requirements. Losses may be offset amongst commonly owned group companies.

Companies in a 100% group may elect to enter into a tax consolidated group, which enables the group to be treated as a single entity for income tax purposes.

New Zealand has a general anti-avoidance provision which allows the Commissioner of Inland Revenue to strike down arrangements that have a purpose or effect (not being incidental) of tax avoidance. Any structuring transaction aimed at achieving tax efficiency should be reviewed in light of this provision.

1.2 Corporate Tax

1.2.1 Income Tax

From the beginning of the 2008/09 income year (1 April 2008 for “standard” balance date companies and as early as 2 October 2007 for early balance date companies) income tax will be levied at the rate of 30% on a New Zealand resident company’s world-wide income. For the 2007/08 and earlier income years the corporate tax rate is 33%. Non-resident companies are taxed at the same rate as New Zealand resident companies on their New Zealand sourced income. There are no state or local income taxes.

Whilst New Zealand does not have a specific capital gains tax, capital gains on certain transactions are deemed to be income subject to income tax. For example, profits from the sale of real and personal property purchased with the purpose of resale or in specified other circumstances are subject to income tax.

1.2.2 Dividends

The income tax payable by a shareholder on a dividend depends on the number of imputation credits which are attached to the dividend. Imputation credits are generated through the payment of income tax by the company and may be carried forward by companies from year to year providing a 66% continuity of shareholding test is maintained.

Provided sufficient imputation credits are attached to a dividend, that dividend may be paid to both resident and non resident shareholders, effectively without the economic cost of further withholding tax being imposed. Under the foreign investor tax credit regime the withholding tax in certain instances may be funded effectively by payment of a supplementary dividend. Subject to certain restrictions the paying company may claim a tax credit for the cost of the supplementary dividends.

1.2.3 Withholding Tax

Interest, dividends and royalties paid to non residents are subject to New Zealand withholding tax. The rate of withholding tax varies depending on whether or not New Zealand has entered into a double tax agreement with the recipient entity’s country of residence. New Zealand currently has double tax agreements in force with 32 countries and a further 2 treaties have been signed but are not yet in force.

Generally the rates are:

	Non-treaty country	Treaty country
Interest	15%	10-15%
Royalties	15%	10-15%
Dividends	15- 30%	15%

The Government has indicated it will review the withholding tax rates as part of its double tax agreement re-negotiation process.

Although withholding tax is levied on dividends, as noted above, effectively the withholding tax may be funded at no additional cost to the company if sufficient imputation credits are attached.

The rate of withholding tax imposed on interest is a minimum tax in the case of non-treaty and certain treaty countries. It can also be reduced to nil if interest is paid to a non-associated party and the security is registered with the Inland Revenue Department. In such circumstances, a 2% 'approved issuer' levy on the gross interest amount is paid. The levy is deductible to the payer.

There is no specific withholding tax on service or management fees. However, the definition of 'royalty' is very wide and can include what might be regarded as service fees in some other jurisdictions. In addition, New Zealand has a strict transfer pricing regime to ensure service charges imposed are at arm's length.

1.3 Goods and Services Tax (GST)

GST is a transaction based tax and is levied on the supply of goods and services in New Zealand and on goods imported into New Zealand (in addition to any Customs duty). GST is levied at the rate of 12.5%, although some supplies are taxed at zero percent (principally exported goods, certain 'exported' services and the transfer of a going-concern) and other supplies including the supply of financial services (other than those which are zero-rated) are exempt from GST. In certain circumstances, taxpayers may elect into the GST business to business (B2B) regime, allowing certain financial services to be zero-rated, to allow the party supplying the financial service to claim input tax deductions.

A 'reverse charge' mechanism requires the self-assessment of GST on the value of services imported by some registered persons. If certain thresholds and criteria are satisfied the recipient of the services must account for GST output tax as if they were the supplier of the inbound services. The reverse charge applies to imported services that are acquired for purposes other than making taxable supplies and that would have been subject to GST if they had been provided in New Zealand.

1.4 Stamp Duty and Gift Duty

Stamp duty has been abolished in respect of instruments executed after 20 May 1999. There is no capital duty on the issue of shares.

Gift duty is levied progressively on most transactions where the consideration provided is less than market value.

1.5 Common Forms of Business Entity

The most common form of business entity used in New Zealand is the limited liability company. A company can be incorporated with relative ease at the Companies Office, which offers an on-line incorporation service.

Another popular investment vehicle is the branch, which, unlike the company, is not a separate legal entity. If operated by a non-resident, the branch is treated as a non-resident for New Zealand tax purposes enabling profits to be repatriated free of withholding tax. The other benefit of a branch structure is the potential to utilise branch losses to offset foreign income. Like the company, a branch must file an income tax return in respect of its New Zealand sourced income. When ascertaining the taxable income of the branch, head office costs can be allocated.

The branch and the company must both file annual audited financial statements with the Companies Office. A non-resident company which operates in New Zealand via a branch must also file its own financial statements with the Companies Office.

Other popular investment vehicles include partnerships, trusts and unincorporated joint ventures. Partnerships and unincorporated joint ventures are not treated as separate entities for assessment purposes and tax is assessed on the participants' share of income. However, legislation currently before Parliament introduces a new limited partnership vehicle. Limited partnerships will have separate legal status but flow through tax treatment.

1.6 Foreign Ownership Restrictions

Irrespective of which structure is utilised, a non-resident may need to obtain consent from the Overseas Investment Office (OIO) to acquire or establish (or acquire a 25% or more ownership or control interest in):

- business or non-land assets worth more than NZ\$100 million; or
- 'sensitive land'; or
- fishing quotas or entitlements.

2. Acquisitions

2.1 The Preference of Purchasers: Stock v. Assets Deal

In most cases vendors prefer to sell stock (shares) in the target company rather than the company's assets. Purchasers on the other hand generally prefer to buy assets rather than shares, as asset deals ensure that the tax history (and risk) remains with the vendor and often allow cost base uplifts.

As a general rule asset transfers must be made at market value for tax purposes. With limited exceptions New Zealand's Income Tax Act does not prescribe how transferred assets are to be valued, simply that they are deemed to be disposed of for a consideration equal to market value.

Specific anti-avoidance provisions address share dealing transactions and cost allocations. The share dealing provisions are designed to counter dividend stripping and loss utilisation arrangements, while the cost allocation provisions give the Commissioner of Inland Revenue the power to determine the cost of some assets transferred on sale.

With a share sale it is usual for the purchaser to seek substantial warranties from the vendor to limit the purchaser's potential liabilities.

2.2 Stock Acquisition

2.2.1 Tax Losses

Losses may be carried forward by companies and branches provided a 49% continuity of ownership test is satisfied from the time the losses are incurred to the time the losses are utilised. There is limited scope to refresh losses before a shareholding change occurs. Losses may not be carried back.

Losses incurred by companies may be used to offset income of other companies in the same group where a 66% commonality of shareholding ownership test is satisfied.

Where a target has a significant amount of tax losses and has appreciating assets, the buyer may consider an asset deal with cost base step up.

2.2.2 Imputation Credits and Other Memorandum Accounts

Imputation credits and other memorandum account credits (such as branch equivalent tax account credits, dividend withholding payment account credits and conduit tax relief account credits) require an at least 66% continuity of ownership test to be satisfied from the time the credits arise to the time they are utilised. Where continuity is breached any brought forward credits are forfeited.

Where a target company has significant imputation credits, a pre-sale dividend or taxable bonus issue should be considered.

Pending reforms to New Zealand's international tax regime mean that certain memorandum accounts including dividend withholding payment and conduit tax relief accounts may no longer be necessary.

2.2.3 Tax Incentives and Concessions

Legislation enacted in 2004 provides an exemption from income tax for gains derived by certain non-residents from the sale of 'shares' in New Zealand unlisted companies that do not have certain prohibited activities as their main activity. The concessions are known as the venture capital tax related reforms.

The legislation targets foreign investors who are materially affected by the imposition of New Zealand tax as they cannot claim or make use of credits for any tax they pay in New Zealand in their own jurisdiction. The rules apply to foreign investors who are resident in all of the countries with which New Zealand has a double tax agreement (except Switzerland) and who invest into New Zealand venture capital opportunities.

R & D credits

The Government has introduced a research and development (R&D) tax credit with effect from 1 April 2008. The credit permits eligible businesses (including those expanding into a prospective line of business) that conduct eligible R&D in New Zealand to claim a credit of 15% of eligible expenditure against their income tax liability. The credit can either be offset against the tax liability of the business, or, if no tax liability exists, be refunded in cash.

2.3 Asset Acquisition

An asset sale must be conducted at arm's length terms or risk being deemed to have been made at market value. However, when the vendor and the purchaser are unrelated the Commissioner of Inland Revenue generally accepts the prices agreed between the parties.

It is prudent to ensure that the values for different assets or categories of asset agreed between the vendor and the purchaser are specified in the sale and purchase agreement.

2.3.1 Depreciation

All depreciation recovered is taxable in the year of sale. Generally proceeds in excess of the original cost of an asset give rise to a non-taxable capital gain.

For an asset deal, generally the purchaser wishes to attribute as much of the purchase price as possible to depreciable assets. A third party purchaser should be able to 'step up' the value of depreciable assets to maximise depreciation claims but it would be advisable for the 'step up' to be supported by a valuation and for the vendor and purchaser to have agreed the purchase price apportionment.

2.3.2 Goodwill

In most cases the vendor would attribute as much of the sale price as possible to goodwill. Generally the disposal of goodwill is not subject to income tax. If the vendor is a company, capital gains can be distributed free of income tax on liquidation (and then generally only to resident shareholders).

The purchaser is not entitled to a tax deduction for goodwill. However, the initial cost of specific types of intangible property, which have a fixed legal life, such as patents, rights to use a copyright or trademarks, may be depreciable.

2.4 Transaction Costs

2.4.1 GST

The transfer of shares is an exempt supply for GST purposes.

The sale of assets is not subject to GST provided the assets are sold as part of a going concern and certain criteria are satisfied. If GST is payable on an asset transaction, the parties may agree to enter into a GST offset arrangement, which effectively avoids the need for any cash to be outlaid. Written approval from the IRD is required for a GST offset arrangement.

2.4.2 Stamp Duty and Gift Duty

No stamp duty is payable on the transfer of real and personal property (including shares) in New Zealand and there is no capital duty on the issue of shares.

Gift duty is levied progressively, at marginal rates from 0% to 25%, on most transactions that involve consideration being provided at less than market value (although unlikely where parties are dealing at arm's length).

2.4.3 Concessions Relating to Mergers and Acquisitions

The Income Tax Act contains some concessions which apply to qualifying amalgamations and tax consolidated groups. Refer to section 5 below.

2.4.4 Tax Deductibility of Transaction Costs

In general, acquisition expenses are accorded the same tax treatment as the assets purchased. For a stock acquisition, therefore, the costs are a non-deductible capital item. However, in certain circumstances, transaction costs incurred directly for the purposes of obtaining funding for the transaction may be deductible. By comparison, an asset acquisition allows for such expenses to be allocated to the assets purchased. To the extent that those assets are depreciable a tax deduction should be available over time for the acquisition costs.

3. Basis of Taxation Following Stock or Asset Acquisition

3.1 Stock Acquisition

Under a stock deal, assets maintain the values they had prior to the acquisition and no step up of the cost basis of the assets is possible.

Most new depreciable assets acquired in New Zealand are eligible for a 20% 'economic loading' on the applicable depreciation rate. If the loading was applied to the assets prior to the acquisition of the company's shares by the purchaser the loading continues to apply to those assets after the acquisition i.e. the purchaser retains the benefit of the depreciation loading.

3.2 Asset Acquisition

Under an asset deal the purchaser may be able to step up the cost base of the assets acquired for tax purposes from the cost base used by the vendor. To the extent the purchase price for depreciable assets exceeds the vendor's cost base, then the third party purchaser should be entitled to increased depreciation claims. However, as the assets acquired by the purchaser are not new assets, the 20% depreciation rate loading does not apply to the assets post acquisition.

4. Financing of Acquisitions

4.1 Thin Capitalisation

New Zealand resident companies and other entities controlled by non-residents (by a 50% or greater ownership interest or by any other means) are subject to the thin capitalisation rules. Under the rules, a deduction for interest is denied to the extent the taxpayer's total interest bearing debt/total asset ratio exceeds:

- 75% of the New Zealand group debt percentage; and
- 110% of the worldwide group debt percentage.

All interest bearing debt is included in the calculation, not only debt with associated parties.

Proposals to extend the thin capitalisation rules to New Zealand entities with offshore investments are under consideration. Once enacted these changes are likely to be effective from the 2009/10 income year.

4.2 Deductibility of Interest

Generally, acquisitions are financed with a mixture of debt and equity.

Most companies are allowed a deduction for interest without the need for a nexus to income. Interest is also deductible where funds are borrowed to acquire shares in a subsidiary. As a result, the use of holding companies in New Zealand is common.

Notwithstanding the thin capitalisation rules, costs incurred in the course of raising finance are normally deductible.

Debt instruments are generally subject to the financial arrangements rules, which require income and expenditure arising from the financial arrangement to be spread over the life of the arrangement on a prescribed basis, generally irrespective of when the payments under the instrument are made.

Certain debt instruments with a very specific set of characteristics are treated as equity for taxation purposes. Such instruments include certain debentures that have been issued in substitution for equity and debentures under which the amount paid is linked to the profit or dividends of the company.

5. Merger

New Zealand has a set of tax and company law rules which allow companies to amalgamate with each other. When two or more companies amalgamate, effective from the date of amalgamation, the company nominated by shareholders succeeds to all rights and obligations of the other amalgamating company or companies. The other companies are struck off the company register.

Wholly owned groups of companies may be amalgamated using a simple 'short form' procedure. Groups of companies not wholly owned must amalgamate under a more complicated 'long form' procedure. For tax purposes the company succeeding on amalgamation takes over the tax obligations of all the amalgamating companies. In the case of a 'qualifying amalgamation', the general rule is that there is no transfer of assets or liabilities for tax purposes, as these are assumed to have been held throughout by the same party, consequently limiting exposure to tax.

As an alternative to amalgamation, companies in a 100% group may elect to form a tax consolidated group which enables the group to be treated as one company for tax purposes. The main advantages of tax consolidation are that transfers of assets between consolidated group members are ignored for tax purposes and compliance requirements are simplified. Care is needed on the exit from a tax consolidated group to ensure previous tax concessions are not unwound. Members of a tax consolidated group are jointly and severally liable for the tax liabilities of group members.

6. Other Structuring and Post Deal Issues

6.1 Repatriation of Profits

Profits may be repatriated in a number of ways, most commonly by the payment of dividends, repayment of debt, royalties, service fees or interest. Each method of repatriation needs to be considered in light of withholding taxes and/or the transfer pricing rules.

As capital gains are not taxable in New Zealand it is more common for non-residents wishing to exit investments to sell shares rather than assets. However, irrespective of whether an investor sells assets or shares, an objective is to minimise withholding tax on repatriation of any surplus cash. This can be achieved in three ways:

- i. Payment of a fully imputed dividend utilising the foreign investor tax credit regime. If shares are being sold, the payment of a dividend before sale enables imputation credits to be used before they are forfeited.
- ii. Capital reduction. New Zealand's company law legislation allows a company to repurchase its own shares if it is permitted to do so under its constitution. Subject to certain "bright line tests" and anti-avoidance rules, a share repurchase is not treated as a dividend to the extent of the company's available subscribed capital.
- iii. Migration of the company. New Zealand's company law legislation allows a company to be removed from New Zealand's register and placed on an overseas register. Under legislation expected to be passed in March 2006, a migrating company will be treated as if it has been liquidated and a distribution paid to its shareholders. The resulting deemed distribution will be free of withholding tax only to the extent of available imputation credits and the company's available subscribed capital. A company's ability to migrate depends on whether the foreign jurisdiction's corporate law provides for migration.

The repayment of debt from an overseas associate is not subject to withholding tax and is therefore a simple method of repatriating cash.

6.2 Conduit Tax Relief

New Zealand's conduit tax relief provisions provide relief from New Zealand income tax for a foreign investor making an equity investment in a foreign company via a New Zealand company. The level of relief is dependent on the extent to which the New Zealand company is owned by non resident shareholders.

Essentially the conduit tax relief regime shelters from New Zealand tax, taxable income derived from controlled foreign companies and dividends from foreign companies to the extent that the shareholders of the New Zealand company are non-residents. Upon ultimate distribution to non-resident shareholders, a 15% non-resident withholding tax is imposed (30% if the non-resident shareholders are residents of a country with which New Zealand does not have a double tax treaty).

The Government has announced that the conduit tax relief regime will be repealed from the 2009/10 income year.

7. Disposal - The Preference of Sellers: Stock v. Asset Deal

7.1 Stock Deal

There are generally no tax consequences for the vendor on a sale of shares provided the shares are held by the vendor as capital assets. Although a share sale is beneficial for the vendor, it is usual for the purchaser to seek substantial warranties / indemnities from the vendor to limit potential tax liabilities.

Generally with an asset sale the vendor will aim to attribute values that are as high as possible to items such as goodwill or other capital assets, as any gain on disposal of such assets is generally non-taxable.

7.1.1 Distribution of Profits

If the vendor is a New Zealand company, the distribution of sale proceeds to shareholders as a dividend (and, in certain instances, on liquidation) attracts withholding tax unless imputation credits are attached. The sale itself generally will not generate imputation credits as the gain is usually a non-taxable capital gain.

Other methods of distribution, which allow shareholders to receive sale proceeds tax free if certain requirements are met, are often possible.

7.2 Asset Sale – Profit on Sale of Assets

As noted above, most vendors prefer to attribute as much of the sale proceeds as possible to goodwill as the disposal of goodwill is not generally subject to income tax.

Depreciation previously claimed on an asset is reversed and, therefore, subject to tax if the sale proceeds exceed the asset's tax depreciated value. Proceeds in excess of original cost generally give rise to a non-taxable capital gain.

If the vendor is a company, proceeds from disposal of goodwill can be distributed tax free only on liquidation of the company (and then only to resident shareholders).

8. Transaction Costs for Seller

8.1 GST

As noted in section 2, the sale of shares is exempt from GST. If assets are sold as part of the sale of a going concern the transaction may be zero rated for GST purposes subject to satisfying certain criteria.

8.2 Stamp Duty

No stamp duty is payable on the sale of either shares or assets.

8.3 M & A Concessions

See comments above in respect of amalgamation.

8.4 Tax Deductibility of Transaction Costs

If a vendor has held the shares being sold as a capital asset, the transaction costs associated with selling those shares are generally not tax deductible. Transaction costs incurred on the disposal of assets used in the income producing process are generally tax deductible.

9. Preparation of Target for Sale

9.1 Transfer of Assets to be Retained to Another Group Company

Generally transfers of assets between group companies must be made at market value. This rule does not apply to transfers of assets between members of a consolidated tax group. If the vendor wishes to retain some of a target's depreciable assets without any adverse tax consequences, it could transfer the assets to be retained to another company where both companies are within the same tax consolidated group. If one of the companies in the consolidated group is sold it will cease to be a member of the consolidated group. Provided the company leaving the consolidated group no longer holds assets that have been transferred to it from another consolidated group member, the sale should have no income tax consequences. There are certain anti-avoidance provisions that will need to be considered.

9.2 Declaration of Dividend Prior to Sale

Given that a company forfeits any brought forward tax losses and imputation credits on a breach of the relevant shareholder continuity tests, the losses and imputation credits should be utilised to the extent possible prior to any share sale. One way of utilising imputation credits is to declare a pre-sale dividend or taxable bonus issue (where there are insufficient profits). A pre-sale dividend could be appropriate where the company has surplus cash or assets which can be distributed to shareholders and the company is able to impute the dividend fully.

10. De-mergers

New Zealand's income tax legislation contains no specific provisions relating to demergers or spin-offs. Certain tracing concessions apply in relation to the shareholder continuity test. A demerger is normally achieved by the sale of assets. However, under the tax consolidation regime reorganisations may be achieved by transferring assets between member companies with tax consequences deferred for tax purposes until an "exit" event occurs. An exit event occurs generally only when a company leaves the consolidated group and then only to the extent that it holds assets transferred to it whilst a member of the group.

11. Listing / Initial Public Offers (IPO)

For companies that are contemplating undertaking an IPO or otherwise listing on a stock exchange, there are a variety of New Zealand tax issues that need to be considered. Usually careful consideration of whether tax losses or imputation credits will be forfeited due to the shareholder changes will be needed. Certain concessions for the shareholder ownership continuity tests could be applicable. To the extent there is reorganisation or transfers of assets etc. in preparation for IPO / listing, the New Zealand tax issues discussed above will need to be considered.

12. Preparation for A Deal

The New Zealand tax and investment environment provides opportunities for structuring investments and tax efficient exit strategies. Careful planning is required to ensure that pitfalls are avoided.

