



April 09

NZ LAW UPDATE

OVERSEAS INVESTMENT ACT REVIEW

The Finance Minister has announced that there will be a review of the Overseas Investment regime that governs foreign investment in New Zealand. The focus will be to:

- put in place immediate measures, so that more applications are decided by the Overseas Investment Office, rather than Ministers. It is anticipated that applications will be turned around more swiftly. These measures will not require any legislative changes.
- consider changes to the Overseas Investment Regulations that dictate other aspects of the application process.
- consider changes to the scope of the overseas investment screening regime generally, for example whether screening thresholds that determine the types of land considered 'sensitive' should be changed.

The aim of the review is intended to make the process quicker and less complex and will have the benefit of stimulating more overseas investment in New Zealand, while also retaining the opportunity to protect assets and land that needs to be protected, but reduce the cost and complexity of decision making.

The Act currently applies to both "sensitive land" and "significant business assets", there is considerable focus on what is, and is not, sensitive land for the purposes of the Act. The definition of sensitive land contains a number of inconsistencies.

It is a reality that many foreign investments in land have to be screened under the Overseas Investment Act because they adjoin areas such as recreation reserves. For example, a proposal for a rest home had to be screened because it was next to a playing field. Any land that exceeds 0.4 hectares in area and adjoins a road or certain types of reserve, which in turn adjoin the sea or a lake, is also classified as sensitive.

It needs to be demonstrated by the investor subject to the regime that the investment will benefit New Zealand. Where the sensitive land includes non-urban land over 5 hectares, the benefit must be substantial and identifiable. The Act and the associated regulations do set out a number of factors that the Overseas Investment Office and the relevant Ministers must consider when assessing the benefit of an overseas investment, but in practice there is no real guidance in the Act or elsewhere as to what constitutes *substantial* and *identifiable* benefit.

It is considered that the review will ensure important sensitive and culturally or historically valuable land be retained while unnecessary barriers to foreign investments that could help the economy are removed. It is anticipated that minor transactions that were never intended to be caught by the Act due to technical drafting issues with the legislation will be ameliorated.

Cabinet agreement to any recommendations arising from the review will be sought by the end of June 2009. The timing of any necessary legislation is yet to be determined by the government but we will keep you posted.

CROWN DEPOSIT GUARANTEE SCHEME – NEW ZEALAND

New Zealand has, like many other governments around the world, introduced a deposit guarantee scheme to ensure ongoing depositor confidence and align the New Zealand market with the rest of the world. The scheme guarantees deposits made by retail investors with three types of financial institutions. The first of these is trading banks, whether locally incorporated or overseas banks that operate through New Zealand branches. Deposits to these will be covered, as will non-resident deposits made in branches of overseas banks. However, for approved local branches of overseas banks existing on 12 October 2008, the guarantee for non-resident depositors is capped at the total amount owed to such depositors at 12 October 2008, allowing for growth of 10% per year. The second type is Non-Bank Deposit Takers (NBDTs) and the third type is Collective Investment Schemes.

Interests in superannuation schemes, unit trusts, shares or similar instruments where the income from the investment is shared, except for cash PIEs, are not covered under the guarantee. Subordinated debt issued by banks or non-bank deposit takers is also not covered.

The scheme guarantees principal and interest for those guaranteed financial institutions that go into default between 12 October 2008 and 12 October 2010. The New Zealand Treasury announced in March of this year that it will continue to review and assess the ongoing need for, and design of, an arrangement, if any, to replace the deposit guarantee scheme. There is a cap on the value of deposits that are guaranteed. The cap is \$1million dollars for individual investors. . To check which financial institute has registered under the Scheme to obtain the benefit of the guarantee view the New Zealand Treasury website (www.treasury.govt.nz)

WHOLESALE GUARANTEE FACILITY

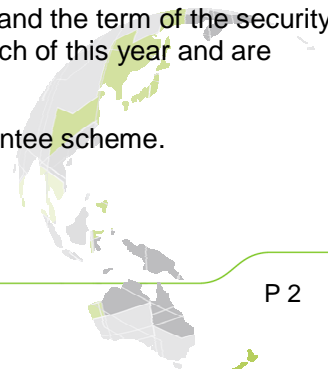
The Crown now offers a wholesale funding guarantee facility to investment-grade financial institutions in New Zealand.

The aim of the facility is to support the re-entry of New Zealand banks to regular foreign markets on a scale commensurate with the economy's overall financing needs. It is available to financial institutions that have an investment grade credit rating and have substantial New Zealand borrowing and lending operations.

The facility operates on an opt-in basis, by institution and by instrument. New issues of senior unsecured negotiable or transferable debt securities are eligible for inclusion.

A guarantee fee is charged, differentiated by the credit rating of the issuer and the term of the security being guaranteed. For further details on the fees, that were revised in March of this year and are reviewed monthly, go to www.treasury.govt.nz

No instruments can be covered by both this scheme and the deposit guarantee scheme.



As a condition of continuing to receive fresh guarantees on new issues, banks utilising this guarantee facility are required to maintain an additional 2 per cent capital buffer on top of the existing required 4 per cent Tier 1 capital. Branches of foreign banks are included among the institutions eligible for a wholesale guarantee but only in respect of their New Zealand dollar issuance.

All issuers in the guarantee facility are required to undertake that the foreign exchange risk associated with the foreign currency borrowing will be hedged and managed.

The guarantee will cover paper issued until its maturity or for up to five years, whichever is the lesser.

Applications to join the facility are sent to The Treasury, which has overall delegated responsibility for management of the scheme.

TRANSFER PRICING

Transfer pricing is the setting of prices for the transfer of goods, services and intangibles between associate parties. New Zealand has transfer pricing legislation to ensure that profits are not manipulated to obtain an overall tax benefit.

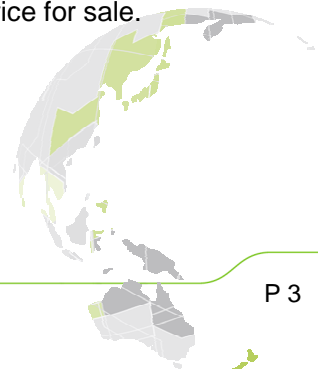
With over two-thirds of world trade involving multinational enterprises “MNEs”, it is estimated that 50% or more of the world trade comprises of associated party transactions. In response, tax authorities around the world are implementing and updating their rules and regulation on international transactions and increasing audits.

The Inland Revenue Department is responsible for identifying which pricing practices are legitimate and those that are not. It has established an International Audit Unit to give advice and assistance to investigators on transfer pricing issues.

A recent Australian case, *Roche Products Pty Limited v CIR* [2008] AATA 639, is the first major decision in Australasia dealing with the application of transfer pricing rules to cross-border transactions.

New Zealand transfer pricing legislation, in common with that in Australia, contains five methods for calculating the arm’s length value for a transaction. They are:

- the comparable uncontrolled price method – involves comparing the controlled price between related parties with an uncontrolled price between independent parties, while addressing various matters to ensure that the prices are comparable.
- the resale price method – takes the resale price of the product acquired at a controlled price and applies an appropriate gross margin to arrive at an arm's length price.
- the cost plus method – takes the costs incurred by the supplier selling at a controlled price and applies an appropriate mark up to arrive at an arms length price for sale.
- the profit split method
- the comparable profits method.



In the *Roche* case it was determined the best method to use was the comparable uncontrolled price method, but the difficulty is that comparable sales are hard to find as, as was noted, pharmaceutical companies rarely sell their products through third parties, and where that does happen, they only deal with marketing processes linked to varying retail circumstances.

In what has been said to be a novel approach, the Court, although presented with a number of expert reports setting out the differing methodology for price determination, did not consider the expert evidence in isolation but also had regard to additional matters it considered relevant such as the profitability of Roche Australia generally and overall market conditions.

This decision is expected to give guidance to those dealing with entities in New Zealand on how to apply the comparable uncontrolled price method where comparables are not readily available.

DISCLAIMER

This publication is necessarily brief and general in nature. You should seek further information before taking any action in relation to the matters dealt with in this publication. If you have any questions on the matters discussed in this update please contact the New Zealand Mackrell Partner, Brian Joyce at Clendons North Shore by email to brian.joyce@clendons-ns.co.nz or phone 64 9 377 8419

