The place where talent does not want to live

The intersection of New Zealand immigration and tax policies in a globalising world

NZIER report to the American Chamber of Commerce in New Zealand, the Auckland Business Chamber, the Edmund Hillary Fellowship and the NZUS Council

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Authorship

This paper was prepared at NZIER by Peter Wilson and Julie Fry.

It was quality approved by Todd Krieble.

The assistance of Phillipa Miller Moore and Sarah Spring is gratefully acknowledged. We would also like to thank the many people who shared their personal stories.

Disclosure of interest: Peter Wilson was Manager of International Tax at the New Zealand Treasury from 1990 to 1997 and Director of Tax Policy from 1998 to 2002. He was responsible for advising the government on many of the tax issues contained in this report.

Julie Fry is a dual New Zealand and US citizen, and her location and financial decisions have been impacted by the tax rules covered by this report.

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Key points

Overcoming New Zealand's twin economic disadvantages of size and distance requires more than the attractions of a picturesque landscape, temperate weather, and hospitable locals.

We need talented people who want to found, manage, advise, mentor and grow companies located here that can be successful without having to produce at scale, close to markets.

Globally, firms are facing increasing competition for skilled people, placing a premium on those prepared to leave home to pursue their lives overseas.

New Zealand has always welcomed immigrants.

Why do so few entrepreneurial migrants arrive and stay here?

In line with global trends, we have been increasing opportunities for temporary residence.

We are not just looking for employees. We also are encouraging people to come to New Zealand and invest their time, skills, and capital in growing the economy.

So far, we have avoided the pitfalls other countries have seen from tying entry to investment. Several countries have recently abolished visas linking entry to specific business and investment activities after these have delivered poor economic outcomes and been subject to corruption.

New Zealand has the right policies in place to attract talented people to come here.

But why aren't we seeing more people arrive and stay?

One reason is that we have an international tax regime that was not designed to reward global success

When introduced in the late 1980s and 1990s, the international tax regime – especially the Foreign Investment Fund (FIF) rules – had two purposes. The first was to limit the ability of New Zealand taxpayers to use tax havens to reduce their domestic tax liabilities. The second was removing tax-driven incentives to invest offshore rather than at home.

The idea that highly talented people with ideas and capital who already had overseas investments might want to come to New Zealand and contribute economically was not top of mind when the FIF regime was introduced.

One of the key design features of the FIF rules is investors are often deemed to be earning a five percent rate of return on the paper value of their investments, regardless of the underlying economic reality of the company. They must pay tax in New Zealand when they have not earned any cash income in the country where their investment is located. This creates a liquidity penalty that does not apply to investments in New Zealand.

In preparing this report, we interviewed a range of people who have left or are considering leaving New Zealand.

The FIF rules impose a tax burden that does not compensate for the many other advantages that New Zealand offers

If people go, we will raise no tax revenue from their overseas investments and lose the people New Zealand needs to be successful.

Our immigration and tax regimes push in different directions.

We recommend the government act quickly to address this situation. We are already seeing talented people leaving New Zealand and spreading the word that New Zealand has a hostile tax regime.

This issue should be addressed on its own merits, not as part of any wider tax policy reforms.

We make some suggestions for what a good combination of tax and immigration policy would look like.

Reform of the FIF rules is required and urgent

We recommend that the government aim to develop principle-based solutions that can be enacted by the start of the 2025 income tax year.

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1 Introduction

In a speech in March 2011, the renowned New Zealand physicist Sir Paul Callaghan laid down a challenge:

We need to create a place where talent wants to live. [1]

Sir Paul's basic idea was that to be successful, New Zealand needed to see the establishment of 100 more global technology companies led by 100 inspired entrepreneurs.[2] But these people had to want to live in New Zealand, over all the other places they could choose.

How can New Zealand rise to meet that challenge? That is the question we address in this paper. The surprising twist in this story is that the answer partly lies in obscure provisions of New Zealand's international tax policy settings.

New Zealand immigration policy encourages talented people to move here, and we have much to offer potential migrants. New Zealand rates highly on international indexes of ease of doing business (World Bank 2019), our government is trusted (OECD 2023a), the country consistently ranks as one of the least corrupt in the world (Transparency International 2024), and it is the most democratic (The Economist 2024).

But our tax system is anything but welcoming, particularly for people who have already been successful overseas and built a portfolio of investments. Discussions we have had with actual and potential migrants and their local advisers confirm that current tax settings are making New Zealand a place where, despite strong attachments to the country, talented people feel unable to stay for financial reasons.

Paying taxes in their new country is an accepted part of immigration. International and local evidence shows that migrants often contribute positively to the host country's finances: they typically pay more in tax than they consume through government expenditure (Blau and Mackie 2017).

But New Zealand's current tax rules require newly arrived migrants, and some returning Kiwis, to pay tax on offshore investments they made before coming here. And the way the system works, they are often required to pay annual tax on the paper value of investments that do not provide any cash return and may not do so for many years – if ever.[3] Worse,

1 At one point, Sir Paul describes the sorts of companies he has in mind as being those that make "weird stuff": specialist products that while they are profitably sold into specialist markets, are often not household items. A video of the speech is available at: https://www.youtube.com/watch?v=OhCAyIllnXY.

2 However, as Rowan Simpson has argued, "it takes much more than one crazy individual to create an enduring high-growth company... Every founder who aspires to build a substantial business needs to hire hundreds of qualified people. We don't only need 100 founders. We need 10,000 people contributing their expertise to these businesses. Then 100,000 more." (Simpson 2021). We agree and note that those 100,000 people do not necessarily all need to be immigrants.

3 New Zealanders who have never lived offshore can be subject to similar rules if they are employed an overseas company (or a subsidiary of an overseas company) and receive shares or options in the overseas parent. While an issue for how New Zealand can access capital from overseas to fund local investments, this issue is outside the scope of this report. It does warrant attention, however.

people who come to New Zealand and are also subject to tax in their country of origin can end up being taxed by that country and New Zealand on the income from the same assets.[4]

These results were deliberate tax policy aims, not mistakes.

Our tax policy settings are not in line with our immigration settings. With one hand, the government is opening the door to entry with a welcoming immigration system, while the other hand slaps immigrants, and sometimes returning New Zealanders, with a punitive tax bill.

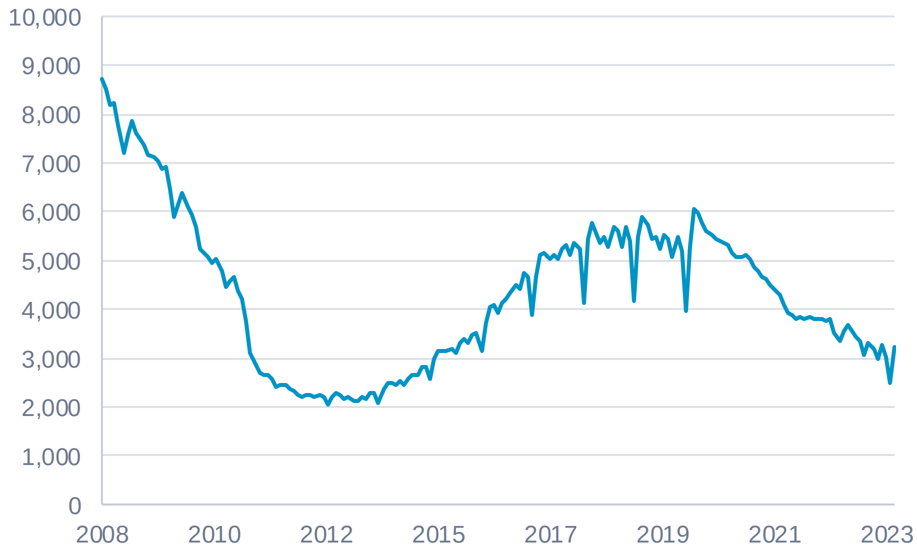
1.1 New Zealand is not attracting talent

Despite its many advantages, New Zealand has never been a particularly popular destination for talented people. Figure 1 shows the total number of people in New Zealand at any time on the various investor and entrepreneur temporary visas that have been available.[5] Note that there has been no discernible uptick in applications since the border reopening.

To put this in context, as of the end of January 2024, over 550,000 people were on residence or temporary visas in New Zealand.[6]

Figure 1 New Zealand has never been a popular destination for talent

Total number of people in New Zealand on investor and entrepreneur temporary visas



Source: MBIE

The current international tax rules were designed for a different world. They made sense when most migration was forever, and many migrants were starting out and seeking a

4 The United States, for example, taxes its citizens on their world-wide income. It is not possible for US citizens to relocate for tax purposes without first surrendering their citizenship. If they do surrender their citizenship and move to another country, they can be subject to special tax. In effect, they are deemed to have sold all of their assets at their market value on that date and are taxed on any gains since acquiring them (United States Internal Revenue Service 2024). Other countries do allow their citizens to lose tax residency, but this usually involves severing most economic and family ties, resigning employment, selling houses and closing bank accounts and spending a period overseas.

5 We have no data on how long people on these visas stay in New Zealand.

6 This excludes visitors and tourists.

better life in a new location with little more than the clothes on their backs and ambition in their hearts.

The world is now a much more mobile place. Developments in technology – the 'Fourth Industrial Revolution' – are increasing global demand for people with human capital (skills) and financial capital (money to invest), and increasingly, people in the prime and middle to later stages of their careers are willing to relocate to meet this demand.[7]

New Zealand has a lot of attractions for potential immigrants, but we are still a small, medium-income country, a long way from centres of world commerce. A desirable lifestyle can only compensate for size and distance to a certain extent.

To be a place where talent wants to live, New Zealand needs immigration and tax rules that fit the modern world. We should be welcoming people to come to New Zealand to succeed.

Those successful people should be taxed on the income they earn in New Zealand and on the income from global investments they make while they are here. That is a fair and efficient approach. The tax rules should protect the tax base from exploitation using the tax regimes of other nations (tax havens).[8] We need rules to protect New Zealand from people with no real link to New Zealand from using the country as a base for illegal activity, money laundering or tax planning. But seeking to tax all people on investments that were made before arrival, especially even when those investments have not yet produced any income, is simply stopping people from coming, constraining their ability to stay as long as they would like, and making them, often regretfully, leave our shores. As a consequence, we are not receiving any significant revenue from this approach.

1.2 Why New Zealand needs to be a place where talent wants to live

From 1938[9] up until the mid-1980s, economic policy in New Zealand was predicated on active state involvement in a policy of planned industrialisation though import substitution (import licensing, discriminatory tariffs and exchange controls) and export promotion (subsidies) (Brooke, Endres, and Rogers 2018, 213).

Initially, this policy, as well as delivering virtually full employment, did seem to generate strong economic growth when viewed in isolation.

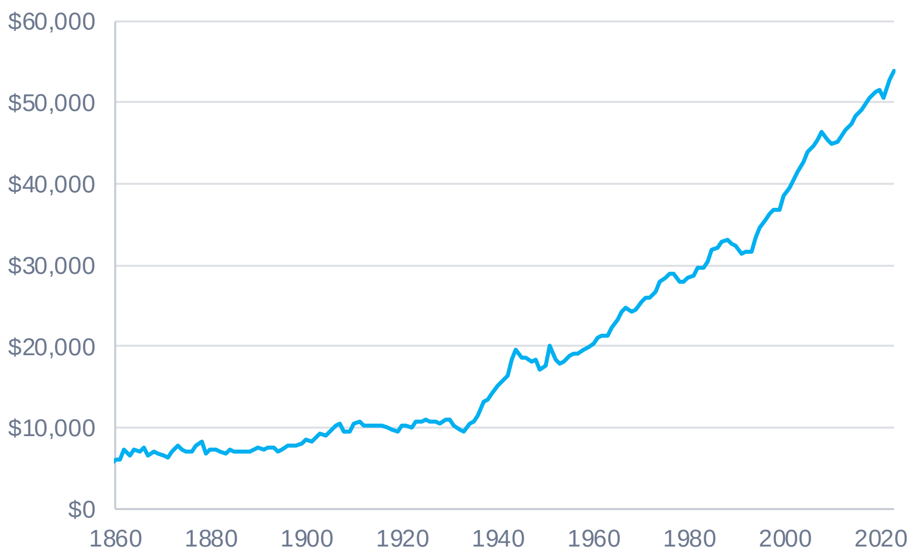
7 Klaus Schwab of the World Economic Forum coined the term Fourth Industrial Revolution to describe the current fusion of technologies that is blurring the lines between the physical, digital and biological spheres. He considers it to be separate from digital revolution starting in the middle of the twentieth century, where electronics and information technology automated production. (Schwab 2016)

8 As we return to below, the current New Zealand tax system has few of the concessions, exemptions and distortions contained in other countries' systems. This increases the need to protect the tax base from exploitation via offshore investments.

9 1938 was the year the first Labour government was elected. It advanced planned economic policy on a wide front (Easton 2020, 268).

Figure 2 The New Zealand economy seemed to grow strongly after 1938

Real per capita GDP

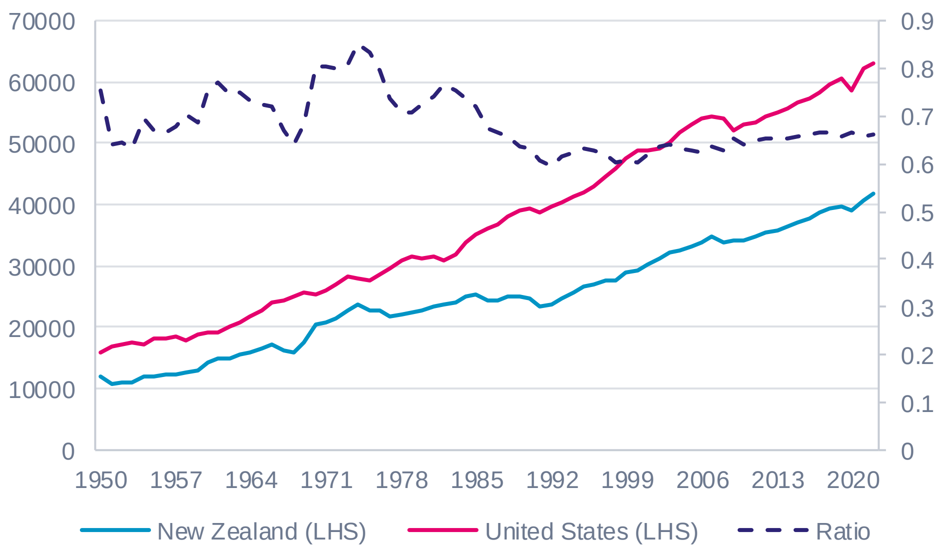


Source: Data 1850[10]

But by the late 1970s, our relative economic performance compared to other OECD countries had started to decline. Figure 3 shows the story of New Zealand's economic performance compared with that of the United States.

Figure 3 A long decline, followed by stabilisation

GDP in $US per capita, adjusted for inflation and exchange rates



Source: Feenstra (2015)

10 https://data1850.nz/

That decline continued until about 1993 when economic growth started again following a period of intensive reforms.[11] Since then, after adjusting for population growth, inflation and exchange rates, the New Zealand economy has grown slightly faster than the US economy. That growth, however, has not been sufficient to recover lost ground on a comparative basis. The trend is similar when New Zealand is compared with other OECD countries (The Treasury 2023a, 8).

Why New Zealand's relative economic performance has not been better is still a matter of much debate. Suggestions include economic geography, low capital intensity, and our slow adoption of productivity-enhancing innovation from the global frontier (The Treasury 2023a); that New Zealand has insufficient capital (Nolan, Fraser, and Conway 2018), that the government needs to focus on building strong innovation systems in a small number of areas of high economic potential (New Zealand Productivity Commission 2023), and that further wide-scale reform is required (New Zealand Initiative 2023). The OECD has pointed to the absence of strong competition pressures, limited integration into the global economy, weak innovation and knowledge transfer, high qualification and skills mismatches, and high corporate taxes limiting investment opportunities (OECD 2022).[12]

We do not think that there is a single reason why New Zealand is not as prosperous as other countries, and thus there is no single solution.[13]

But being a place like Sir Paul Callaghan envisaged – where there are more world-leading innovative companies doing world-leading things – must be part of the solution.

Innovation is much studied.[14] It is a key driver of long-run economic growth (Aghion and Howitt 1992).

> *In the most fundamental sense, there are only two ways of increasing the output of the economy: (1) you can increase the number of inputs that go into the productive process, or (2) if you are clever, you can think of new ways in which you can get more output from the same number of inputs.* (Rosenberg 2006, 43)

But despite the considerable analytical effort expended to understand the economics of being clever, why one company with a promising idea, smart owners, great staff and sufficient capital succeeds, and others with the same features trading under the same market conditions fail is still a mystery. Business is just risky. New business especially so. Entrepreneurs – people with an appetite for risk and the skills needed to reap the rewards that it brings – are thus a part of successful innovation ecosystems.

The effects of being a place where talent lives are more than just increased production, as measured by gross domestic product (GDP). We would expect to see New Zealand

11 There have been several studies of the reforms published. Evans et al. (1996) is comprehensive summary. Mintrom and Thomas (2019) focus on the effect of public sector reforms. Graham Scott, the head of the Treasury during the reform period, has published an extensive discussion on public sector reforms (Scott 2001). For a discussion of the political economy of the reforms, see James (1992). For a more critical assessment highting the distributional impacts of reforms and their perceived lack of impact in reversi ng New Zealand's economic fortunes, see Part V of Easton (2020).

12 Others argue that when measured correctly, New Zealand's relative economic performance is actually quite good (Grimes and Wu 2023; Galt 2023).

13 While preparing this report, it has been evident that successful firms, especially in the tech sector, are increasingly using business models that are strongly influenced by international best practice. The traditional Kiwi model of funding innovation via a mortgage over the entrepreneur's home is being replaced by more sophisticated models that bring together people with ideas and little capital and people with experience in funding and mentoring businesses. Ensuring that the New Zealand regulation of this type of business model is fit-for-purpose is another area that should be investigated. For a recent discussion see Leung et al. (2024).

14 See, for example Aghion and Howitt (1992), Syverson (2011), Aghion et al. (2014), Jones (2016), Kogan (2017), Acemoglu et al. (2018) and Teece (2019).

increasingly becoming a place with attractive investment opportunities for New Zealanders in general, as successful businesses seek local capital.[15]

1.3 The twist

Despite our overtly welcoming – and, in many cases, world-leading – immigration and business policies, there are several ways other policies act as a barrier to New Zealand being a place where talent wants to live.

On the surface, the country appears to have an attractive tax regime. New Zealand is rated as the third most competitive tax regime in the Tax Foundation's 2023 *International Tax Competitiveness Index* (Mengden 2023). This finding features prominently in material promoting New Zealand as an investment destination (New Zealand Trade and Enterprise 2023).

While looking comprehensive, this index does not include a small but very important tax regime that has a significant adverse effect on people who become tax residents after they have accumulated a portfolio of what are now for them overseas investments.

New Zealand is an outlier within the OECD when it comes to taxing residents on their overseas portfolio (non-controlling) interests

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The Foreign Investment Fund (FIF) rules in effect apply tax on deemed income based on the paper value of the investment at the commencement of each tax year. There is no allowance for company tax paid in the country where an international company is located. New Zealand's extensive network of double taxation agreements does not provide any relief.[16]

While some other OECD countries have regimes that tax their residents on investments in low tax countries – tax havens – few impose an additional layer of tax on income that is earned in high tax countries (Devereux et al. 2021, 92). It can, therefore, be a shock to foreigners thinking of coming to New Zealand when they learn of the extent of the New Zealand tax system. They are taxed by New Zealand on types of income that their home country would normally not tax. In part, this is because of the mismatch between what the FIF regime taxes (being unrealised gains and deemed income) and what most other

15 A common theme in our discussions was that investments in listed New Zealand companies did not offer the sorts of returns on offer on stock exchanges overseas, including the NASDAQ.

16 Double tax agreements (DTAs) assign taxing rights between two countries on cross-border income. New Zealand's network of DTAs is largely based on a model developed by the OECD. (Inland Revenue Department 2024). That model generally allows the country where income is earned (the source country) to have the first right of taxation, with the other country (the residence country), having the ability to apply an additional layer of tax that is less than its normal rate. The combined rate of tax is generally the same as what a person in the residence country would pay on domestic income in their home country. As we explain in Section 3.3.1 on page 21, the tax issue that the FIF regime addresses is when people own shares in a company that is resident overseas. Legally, it is the company that is earning the income, not the shareholder. What the FIF regime does is deem the shareholder to have derived a notional amount of income that is included in their taxable income in New Zealand. New Zealand has no obligation under its DTAs to provide relief from double taxation imposed on residents that is calculated on a notional basis under New Zealand domestic law. If the entity pays dividends, and the source country imposes withholding taxes on them, then New Zealand would be required to reduce its tax take on that income in accordance with the DTA.

jurisdictions tax (being dividends or other forms of income and, in many jurisdictions, realised capital gains).[17]

It is easy to get tax residency in New Zealand, and it is hard to lose. There are two avenues to becoming a tax resident. First, a person needs to spend a total of 183 days in any 12-month period (note that the days do not have to be consecutive).[18] The alternative residence test is that a person has a permanent place of abode in New Zealand, even if they have a permanent place of abode in another country.[19] To cease being a resident, they must be physically absent for 325 days in any 12-month period and not have a permanent place of abode in New Zealand.[20] Once resident, people are taxed on their world-wide income.[21]

New Zealand's tax rules were not designed with the idea of welcoming globally mobile talent in mind.

1.4 The problem

Immigration and tax are two of the most powerful policy levers available to the government to influence a nation's economic and social progress. Immigration policy, done well, can produce gains for the immigrants and their new host nation. A good tax policy is one that raises sufficient revenue at the least overall cost to the country.

There are, however, many ways in which governments can, for a variety of reasons, get immigration and tax policy settings wrong. These reasons range from outright corruption to favouring vested interests to the verisimilitudes of modern politics. The consequences can be dire.

Here, we are examining the intersection of two complex policy areas, which makes the possibility of poor policy even more likely.

As we will see, New Zealand has a long tradition, supported by many reviews, of wanting to attract talented immigrants.

And it has a long tradition, supported by many other reviews, of imposing very heavy taxation on talented immigrants.

The result is an open door, accompanied by a large tax bill

17 While the practices and experiences of other countries are always a useful guide to developing tax policy, the great diversity in tax systems means that there will likely always be another OECD country somewhere that applies a lower effective tax rate on some activity than New Zealand. That is not in itself a reason why New Zealand should follow suit. As we note throughout this report, people make their decisions about where to live and invest based on many criteria, of which tax is one. In this regard, many countries with low overall tax burdens also have, as a result, very low levels of public services.

18 Section YD1(3) of the Income Tax Act 2007.

19 Section YD1(2) of the Income Tax Act 2007. The permanent place of abode test will often mean that a person who is not physically present in New Zealand for 325 days will continue to be a resident for tax purposes (Inland Revenue Department 2004, 7).

20 Inland Revenue Department (2004, 7).

21 Non-residents are only taxed on income that has a New Zealand source.

In this report, we focus on three distinct groups of people:

- People born in New Zealand who have spent some time overseas and become successful and are now thinking about returning home
- Highly skilled migrants coming to New Zealand for the first time
- Part-time residents in New Zealand, such as Investor Visa holders who, as we will see, are actively limiting their time in New Zealand to avoid tax residency.[22]

The tax considerations applying to each group are slightly different. We return to this in section 3.2.

1.5 Focusing on one issue

While there are undoubtedly many ways the New Zealand tax system, its international rules in particular, could be improved, this paper is not about that. We have deliberately kept the focus tightly on the issue of the application of the FIF rules to new immigrants and returning Kiwis who have built up investments before they arrived and who become subject to the FIF rules if they become a tax resident.[23]

The efficiency and equity case for doing something about this group of people Is strong. Given the urgency of this matter – we have been told people are already leaving New Zealand because of our tax settings and that it is becoming harder to recruit the talent that we need – we are proposing targeted amendments rather than suggesting more fundamental reforms to either the international tax regime or the wider income tax system.[24]

22 We do not consider the case of New Zealand-born tax residents who have never lived overseas. We consider that the current tax treatment of their offshore holdings is appropriate, within the context of current tax policy. That does not mean that there is never going to be a case for reviewing the current tax treatment of these people. It is just that that would need to be part of a wider revision of tax policy, for example if New Zealand moved to apply a capital gains tax on holdings of domestic shares.

23 During our analysis, we did however observe some related policies areas that appear to warrant further examination as a separate exercise. We have noted these as appropriate.

24 For example, a generalised capital gains tax that applied equally to local and foreign investments might also remove the tax barrier to moving to New Zealand we have identified. If such a tax were ever introduced, then that would be the time to address the structure of international tax. However, as we note in section 3.4.1, the FIF regime is not needed because of the absence of a capital gains tax, but as a way of taxing the income that New Zealand residents earn in offshore entities that are outside New Zealand's direct taxing powers

2 Thinking about immigration

A lot of thinking about immigration policy internationally and in New Zealand has been framed within a settler migration paradigm, summed-up in these words on the Statute of Liberty:

> *Give me your tired, your poor, your huddled masses yearning to breathe free.* [25]

The assumption embedded in this paradigm is that migration is forever, with success measured in terms of how quickly migrants assimilate and become indistinguishable from locals economically.[26]

The four British settler colonies – New Zealand, Australia, Canada and the United States – were all colonised based on mass migration of often poor people, seeking to build a new, permanent life away from the struggles of Britain and Europe. In New Zealand, the original aim was to build a 'Better Britain' in the south Pacific.[27] Heartbreaking scenes on the docks reflected the reality that most people setting out to spend six months in a leaky boat would never see the loved ones they were saying goodbye to again.

The extent and type of people flows across the world are very different now. Increasing mobility has been facilitated by cheaper and more efficient travel and advances in communication, both of which make it easier to keep in touch with families and friends at home. Extensive short-term visa-free travel arrangements have enabled growing numbers of people to check out possible migration destinations as tourists. International agreements have opened up legitimate pathways for temporary migrants who, in years gone by, may have worked illegally.

Both the demand for and supply of people, particularly those with portable skills, have changed significantly. Policy makers recognise that the most valuable migrants have many possible destinations and compete to attract them. Innovative policy approaches are tested, copied and adapted elsewhere.

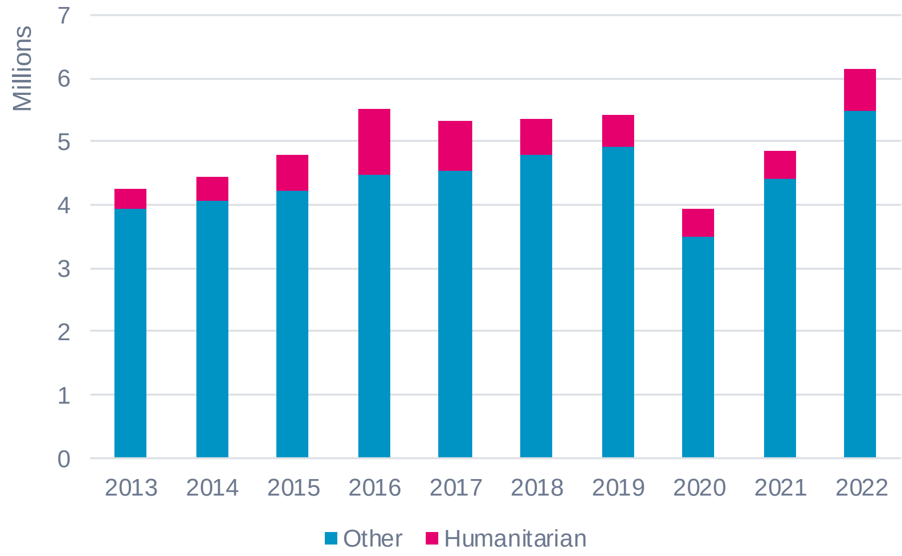
There are more migrants overall and many more temporary migrants than even 25 years ago. The latest OECD International Migration Outlook records that across all member countries, permanent immigration is at record levels (OECD 2023b).

25 The *New Colossus* by Emma Lazarus (1849–1887).

26 To live the American dream, one needed to become American and acquire the attitudes, sentiments and even the memories of the host country (Alba and Nee 1997, 828). Similarly, Nigel Murphy noted that "New Zealand governments in the 1950s and 1960s also pursued a policy of assimilation, whereby Chinese New Zealanders were to be encouraged to be white New Zealanders as much as possible" (Murphy 2003, 65).

27 While not the subject of this report, this came at an immense, and still not fully recognised, cost to Māori. The indigenous peoples of Australia, Canada and the United States fared even worse. One telling statistic is the size of the indigenous populations in these four countries today, remembering that prior to the arrival of Europeans, it was 100 percent of total population. The Aboriginal population of Australia is currently about 3.2 percent of the total population (Australian Bureau of Statistics 2022); in the United States the indigenous population is about 2.9 percent (US Census Bureau 2022) and in Canada, the comparable figure is 5.0 percent. (Government of Canada 2022). In New Zealand, the Māori population is approximately 17.4 percent (Stats NZ 2022).

Figure 4 Permanent-type migration to the OECD, 2013-2022



Source: OECD (2023b)

Globally, there is also an increasing trend for greater short- and medium-term mobility.

> *Highly skilled workers are a crucial and relatively scarce input into the productive and innovative processes of firms. The relevant talent pool for these workers is global.* (Glennon 2024, 3)

On the demand side, the Fourth Industrial Revolution is driving many employers to look overseas for employees with technology and management skills. This is being matched by an increase in people being prepared to move to other countries to gain higher returns from in-demand skills (Lazarova et al. 2023).

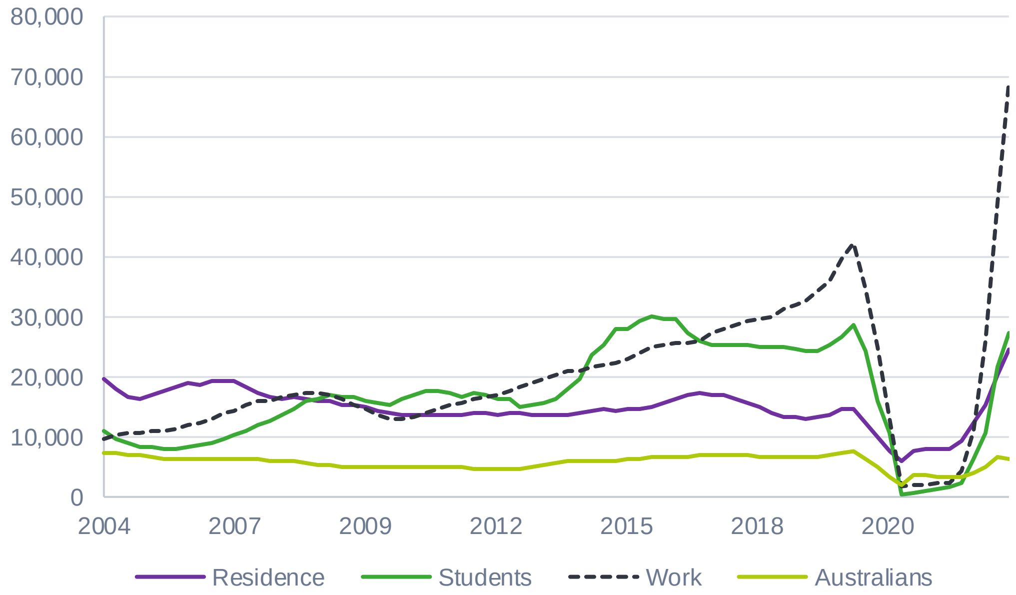
New Zealand has seen a similar trend.[28] Figure 5 shows that the number of people settling on a residence visa was slowly falling before the COVID-19 border closures, while the number of Australians, who have full work rights in New Zealand, remained relatively steady. At the same time, the number of people arriving on short-term temporary work visas has increased dramatically, and there have been significant increases in the number of students with work rights.[29] This trend has resulted from a deliberate policy shift on the part of successive New Zealand governments.

[28] Stats NZ, Immigration NZ and Inland Revenue use different definitions of migrants. Immigration NZ uses visa categories to define whether someone is a permanent or temporary immigrant. People grated a residence class visa have unlimited lifetime rights to live and work in New Zealand, have access to publicly provided health, education and welfare services and can vote. People granted a temporary work visa, on the other hand, have restrictions on the jobs they can work in (they are often tied to a single employer) and do not have access to publicly funded health care (having health insurance is often a condition of granting a visa). Stats NZ's definition of migrant is based on the length of time someone spends in New Zealand. Under the current approach, which dates from November 2018, a person who enters New Zealand is regarded as a migrant if they are physically present in the country in 12 of the 16 months after their arrival. For a more detailed description of the current approach, see Stats NZ (2017). Under the income tax law, a person who spends 183 days out of any continuous 365-day period, or who has a permanent place of abode in New Zealand, is a resident for tax purposes.

[29] Tertiary students in New Zealand on a student visa (which includes people enrolled at a tertiary institution or a private training establishment) are permitted to work up to 20 hours per week during term time and full-time during holidays (Immigration New Zealand 2021, sec. U13.15).

Figure 5 A shift in the composition of immigrants

Migrant arrivals, Stats NZ definition, 12 months ending each month



Source: Stats NZ

2.1 Why invite migrants?

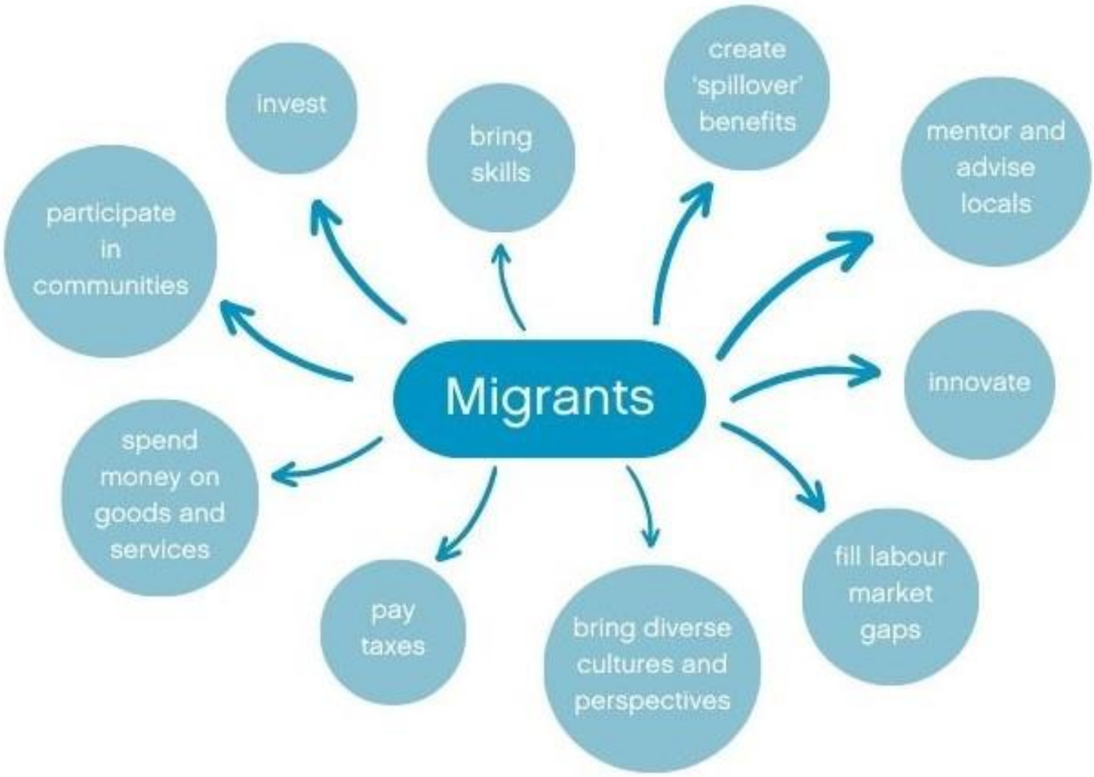
In our view, the goal of immigration policy should be twofold. We want New Zealand to be a place that is attractive to permanent settlers, but we also want to become a nation that enables the most talented migrants to maximise their contribution to wellbeing – both ours and theirs – regardless of the length of time they wish to spend in the country.

When immigration policy settings and practice are well-managed, immigration can improve the wellbeing of both migrants and locals (Fry and Wilson 2018). While costs, such as the need to build more physical infrastructure as the population grows, will always need to be managed, the benefits of immigration can be shared between:

- migrants, in terms of the income and investment returns they earn and the benefits they receive from spending and reinvesting those and participating in a new community
- their employers, who under current New Zealand immigration settings have access to workers who are often willing to work in positions that are unattractive to locals
- their employees, who can access jobs, opportunities for skill development and financial returns that would otherwise be unavailable
- the wider economy and society, partly via the economic boost from immigrants' spending and investment, but also from the diversity of ideas and vibrancy they bring with them, which often lead to 'spillover' benefits.[30]

30 Skilled migrants create spillover benefits when they collaborate closely and share different knowledge, expertise and trusted networks with their new colleagues. International studies also find that higher levels of ethnic diversity bring positive but small benefits to productivity, creativity and innovation (Fry and Wilson 2018, 102, internal citations omitted).

Figure 6 How migrants can contribute to New Zealand



Source: The authors

Rather than being measured by narrow criteria like GDP, employment or wages, wellbeing should be understood as a broad, multi-dimensional concept.

This is the approach we have used in this report.[31] Success in our framework is when the wellbeing of locals increases (or at least does not fall) due to immigration, and migrants are treated at least as well as locals.[32]

This contrasts with economists' traditional measures of migrant integration.[33] In conventional economic frameworks, success is when immigrants, on average, earn the same as locals, after adjusting for individual characteristics like qualifications, skills, experience and age.

31 Fry and Wilson (2018) sets out the case for using a wellbeing framework for setting immigration policy in New Zealand.

32 Immigrants must become New Zealand citizens to receive full equal treatment when it comes to political and democratic rights. For example, permanent residents cannot generally access consular assistance by New Zealand embassies when they travel. While they can vote in elections, permanent residents must reside in New Zealand to be eligible to do so. Citizens can vote if they have been outside New Zealand for less than six years, while for permanent residents, the limit is four years. New Zealand superannuation is currently available to anyone living in New Zealand when they turn 65, if they have lived in New Zealand for at least 20 years (including 5 years since they turned 50). This means that migrants who are over the age of 45 when they first arrive in New Zealand can never be eligible for New Zealand Superannuation.

33 Studies that we have found useful in understanding the economics of immigration are Hanson (2008); Kerr and Kerr (2011); Borjas (2015); Dustmann and Görlach (2016); Blau and Mackie (2017); Quak (2019); Dowlah (2020); Fasani et al. (2020) and Walerych (2020), together with several meta-studies by Longhi et al. (2005; 2010; 2008a; 2008b).

We argue that a broader focus is needed, one that expressly acknowledges that the motivation of many talented migrants has shifted from permanent settlement and assimilation to becoming global citizens based in and making contributions both within and beyond the labour market, in more than one location.

Research and policy are still catching up with this reality.

2.2 New Zealand's immigration policy history

New Zealand's policy on immigration has developed since 1840, going from open borders after the signing of the Treaty of Waitangi to the sophisticated regime in the Immigration Act today (see Spoonley and Bedford (2012) and Fry and Wilson (2018) for histories).

While progressively stricter regimes have developed, New Zealand has always been willing to accept migrants wanting to build a better life here (Phillips 2015). Early restrictions on immigration were racially motivated, with a clear preference for British settlers and a clear bias against Chinese immigrants (Spoonley and Bedford 2012, 102).[34] Immigration was restricted to 'traditional' source countries in Northern Europe, with some special categories for the Pacific. The primary focus was on permanent ('settler') migration.

More recently, official government thinking has viewed immigration as essential for New Zealand's economic development (Wilson and Fry 2020, 4).

In 1987, New Zealand moved to a neutral policy, where entry was based on other criteria (education, skills, job match, etc.). In announcing the new policy on permanent settlement, the then Minister for Immigration said:

> *[T]he Government decided with effect from the beginning of 1986 to abolish national origin as a factor in immigrant selection and to assess applicants solely on criteria which evaluate personal qualities, skills, qualifications, potential contribution to the New Zealand economy and society and capacity to settle well in this country.* (Burke 1986, 15)

The initial focus of the new regime was to seek people who could permanently increase New Zealand's stock of human capital. Migrants were selected based on their qualifications, experience and age.

Unfortunately, many highly skilled migrants arrived in New Zealand only to discover there were few opportunities available to make use of their skills. Media stories of migrants with PhDs driving taxis abounded (Spoonley and Bedford 2012, 85–86).

Policy makers responded in two main ways: by increasing the emphasis on having a local job offer, and by expanding opportunities for business, entrepreneur, and investor migrants.

These look like simple, logical steps. In practice, there has been an ongoing process of testing, learning and adjusting immigration policy, with many challenges along the way.

In the mid-2000s, temporary migration began to increase rapidly in response to both strong labour shortages and a desire to boost the export education industry. Over time, export education policy moved from targeting fee-paying PhD students, with the expectation that

[34] The first general legislation controlling cross-border people flows, the Immigration Restriction Act 1899, continued to allow free entry to British subjects, but limited entry to people who were literate in a European language. In practice, English was the language tested (Fry and Wilson 2018, 28).

they would stay in New Zealand after graduation, to supporting low-quality English language schools. While the fiscal contribution of students was welcomed, there was much less emphasis on ensuring they received a quality education. To attract more students at all levels, work rights were significantly expanded over time.[35] Students were also enticed to New Zealand by the prospect of obtaining residence at the end of their studies.

There have been ongoing concerns about the calibre of migrants entering the country being less than policy intended.

> *Over time, the skill levels of permanent migrants continued to fall. And, rather than bringing in modest numbers of people with the potential to transform the New Zealand economy, temporary visas were increasingly granted to large numbers of people with skills at or below the New Zealand average.* (Wilson and Fry 2020, 18)

In 2013, MBIE noted that many former students who were granted residence had "significantly lower levels of skills than were anticipated when the policy was designed" and were "more likely to take up semi-skilled service-sector employment" (Ministry of Business, Innovation and Employment 2013, Appendix 3, 3.). MBIE also reported that only 60 percent of people granted Essential Skills visas in the 2011/12 financial year were in skilled occupations (ibid., Appendix 1, 4). Moreover, there were reports of the system being gamed through inflated job-titles and people paying to receive job offers (ibid.).

In 2021, MBIE noted that nearly half of the people granted an Essential Skills Visa in 2019/20 were at the two lowest (out of five) skill levels, up from 28 percent in 2010/11 (Ministry of Business, Innovation and Employment 2021, 7).

A similar pattern was observed in entrepreneur and investor-class visas. At one point, Immigration New Zealand was accepting investment in $2 shops and fast-food franchises as an entrepreneurial investment. In part, outcomes like this resulted from visa conditions focusing on what was measurable and low risk and the inherent inability of anyone – including public servants – to 'pick winners'.

In 2019, as part of its regular programme of reviews of the New Zealand economy, the OECD undertook a deep dive into immigration policy. Its overall conclusion was that the system was sound (Carey 2019, 11).

In 2021, the government referred the issue of immigration settings to the Productivity Commission. Following extensive study, [36] the Commission concluded:

> *Immigration has had small and mostly positive effects on the wages and employment of New Zealand-born workers over the last 25 years. Overall evidence on labour market effects does not, of itself, point to major problems with the level and composition of immigration into New Zealand*. (New Zealand Productivity Commission 2021c, 1)

35 For example, in January 2014, all international students in New Zealand enrolled in an English language course with a high-quality education provider lasting fourteen weeks or longer were granted the right to work part time. International students taking a course lasting for an academic year or longer were granted the right to work full-time work during all scheduled holidays. International doctoral and master's research students were granted unlimited work rights while studying (Fry and Wilson 2018, 40).

36 As part of its work, the Commission undertook a major in-house research programme on the issue: see Productivity Commission (2021b; 2021c; 2021d; 2021e; 2021d; 2022). The Commission also commissioned three external research reports: Taylor Fry Ltd (2021); WhāiaLegal (2021) and Wilson and Fry (2022). The Commission's publication *Immigration by the numbers* provides an up-to-date source of much relevant data (New Zealand Productivity Commission. 2022).

At a high level, New Zealand currently operates an open, welcoming immigration system. The available evidence confirms that immigration positively contributes to New Zealand across many domains of wellbeing (New Zealand Productivity Commission 2022). Opportunities for improvement exist (Fry and Wilson 2020), and ongoing reports of migrant exploitation point to fundamental power imbalances between migrants and their employers that need to be addressed.[37]

2.2.1 Our evolving strategy

New Zealand wants to welcome talented migrants who wish to contribute here. Successive governments have offered entry on a temporary and permanent basis to people with high levels of skills, even if, in practice, relatively few of them have taken the offer up (Wilson and Fry 2020, 18). There has also been a growing appreciation that, when seeking to attract entrepreneurial and investor migrants, greater upside potential will involve taking on a greater degree of risk. As Madeleine Sumption once noted:

> *Successful entrepreneurs are a rare breed. Most people do not start businesses, and most of those who do fail. Even venture capitalists, who specialise in identifying good business ideas, accept high failure rates as normal and unavoidable.* (Sumption 2012)

One recent example that explicitly recognised the need to better balance risk and potential return was the Global Impact Visa, which operated as a pilot for four years between 2017 and 2021:

> *The Global Impact Visa … provides individual pioneering entrepreneurs and investors with a 3-year visa to create, support, and incubate ventures and models that result in positive global impact, from New Zealand. After 3 years, migrants can qualify for permanent residency.* (Immigration New Zealand 2024a)

Both local and international 'fellows' were selected, and eligible fellows living overseas were granted a Global Impact Visa. Up to 100 visas were permitted to be issued each year of the trial (Fry and Wilson 2018, 36). One particular feature of the visa was that the selection of candidates was undertaken by the Edmund Hillary Fellowship, a wholly-owned subsidiary of the Hillary Institute for International Leadership (Edmund Hillary Fellowship 2022).

Evaluations of the program showed mixed results, partly due to disruptions caused by the COVID-19 lockdowns.[38] Some of this variability was expected, because decision makers took calculated risks when selecting fellows with a view to achieving better overall results. They recognised in doing this that the likelihood of worse outcomes was also increased relative to conventional policy approaches, which tended to focus on applicants providing detailed business plans and commitments to create local jobs.

[37] An issue is the approach followed in a number of New Zealand visas of tying a migrant to a specific employer, which greatly limits the ability of migrants to credibly threaten to resign if they are ill-treated (New Zealand Productivity Commission 2021a, 30).

[38] The pilot was said to be "progressing well" with "strong potential… to deliver much greater outcomes in future – especially if support for integration is improved". International fellows "are generally considered to be 'high calibre' – they offer skills and access to networks that are not commonly available in New Zealand". In terms of outcomes, "Fellows have created New Zealand-based jobs and organisations, invested in and raised capital for New Zealand-based organisations, and held governance roles in New Zealand". Many international fellows "report high levels of commitment to New Zealand, intend to apply for permanent residency when they are able, and intend to increase their contributions in future" (Ministry of Business, Innovation & Employment 2021, 1).

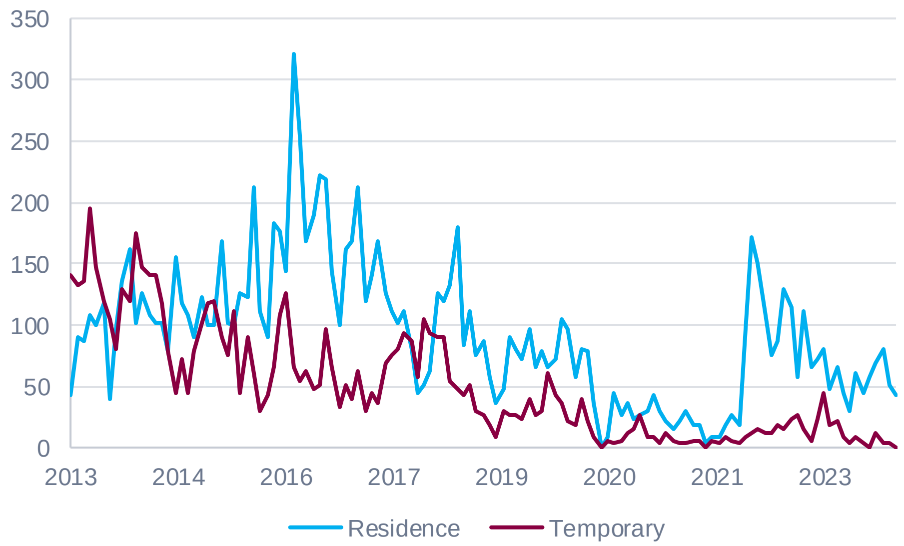
The latest development in attracting talented people came when the previous government introduced a new Active Investor Plus Visa in September 2022. To qualify for the visa, a person must:

- invest a total of between NZ$5 million and NZ$15 million (depending on a weighting system that incentivises more active investments)
- invest across three years and maintain the investment for a further fourth year
- spend 117 days in New Zealand across the four-year conditional visa period
- have a reasonable command of English.

At the end of the four-year investment period, visa holders can apply for permanent residency.

Despite being the new home for some remarkable people, New Zealand has never attracted many immigrants under the various investor and entrepreneur visa classes. Figure 7 shows the number of visas issued under these categories for both permanent and temporary immigrants.

Figure 7 A small number of visas each month



Source: MBIE

2.3 Immigration as protection

Until the start of the twentieth century, free passage of people across borders was the international default (Vernon and Zimmermann 2021, 6).[39] Now, the requirement to have a passport and visa is near universal.[40] One common objective of current border controls is to limit the inflow of criminals and people posing risks to national security. Therefore, all

[39] One of the first Acts of the new Australian Federal Parliament in 1901 was passing a law limiting immigration (Langfield 1999). The United Kingdom Parliament passed the Aliens Act in 1905 as its first step to introducing a system of border control (Wray 2006).The requirement to have a visa to enter the United States dates from 1924 (Guerreiro, Rebelo, and Teles 2020). New Zealand was a relatively early adopter of restrictions, with the first legislation being enacted in 1899 (Fry and Wilson 2018).

[40] Even citizens of EU members countries traveling within the Union must carry a valid passport and produce it when required (European Union 2024).

applicants for a visa to enter New Zealand must be of good character and not pose a potential security threat. [41]

Beyond these physical limitations, many countries, including New Zealand, apply additional regulatory regimes that protect them from malicious cross-border activity.

New Zealand has an enviable reputation for being honest

We currently rate third on Transparency International's index of the world's least corrupt countries.[42]

Ensuring that we have immigration and tax settings that continue to support that reputation is an important goal. And here, perceptions matter as much as reality.

Any changes to the tax treatment of immigrants or returning New Zealanders with existing investments will need to be considered in the context of ongoing activity by international bodies actively promoting policies that protect countries. New Zealand's reputation for being an honest, transparent country that supports international efforts to promote a rules-based international order must be enhanced by any reforms.

We discuss the principal areas that will require consideration in Appendix A.

41 The current good character tests include checking for previous criminal convictions, likelihood of committing a serious criminal offence in New Zealand, being a threat to public order, being a member of a designated terrorist entity or being a person whose entry would pose a risk to New Zealand's international reputation (Immigration New Zealand 2021, sec. A5.1).

42 Denmark rates first with a score of 90 out of 100, while Finland scored 87 and New Zealand 85 (Transparency International 2024).

3 Tax policy

We now discuss the taxation of recent immigrants and returning New Zealand citizens.

3.1 No firm rules

Because bilateral and multilateral tax rules only take effect once incorporated into domestic law, every country can design its tax system to promote its objectives.[43] And as every country in the world takes a different view, and at times a materially different view of the appropriate way to apply these concepts, there is no 'right answer' regarding tax policy. What other countries do can provide valuable lessons, but there is no 'international best practice' to apply.[44]

While there are common themes, the details vary considerably from country to country. We have included a brief discussion of some of the main international tax concepts that we discuss below in Appendix B.

3.2 The current New Zealand approach

As we discussed in section 1.4. we are focussing on three groups of people:[45]

- People born in New Zealand who have spent some time overseas, become successful, made investments, and are now thinking about returning home
- Highly skilled migrants and entrepreneurs coming to New Zealand for the first time
- People, such as Investor Visa holders who, as we will see, are actively limiting their time in New Zealand to avoid tax residency.

Under the current tax law, the first two groups are taxed the same as people who have always been tax residents and have never lived overseas. They are taxed by New Zealand on their world-wide income, including under the FIF rules.[46]

The third group are not residents of New Zealand, and so will only be taxed on income that is earned in New Zealand.[47]

Figure 8 is a high-level distinction between the two separate approaches.

43 While there is general variability in tax design, we note that there is a large and growing gap between United States policy and international norms (Merrill 2010). Few would argue that the United States provides a template for good tax policy design (Slemrod and Bakija 2017).

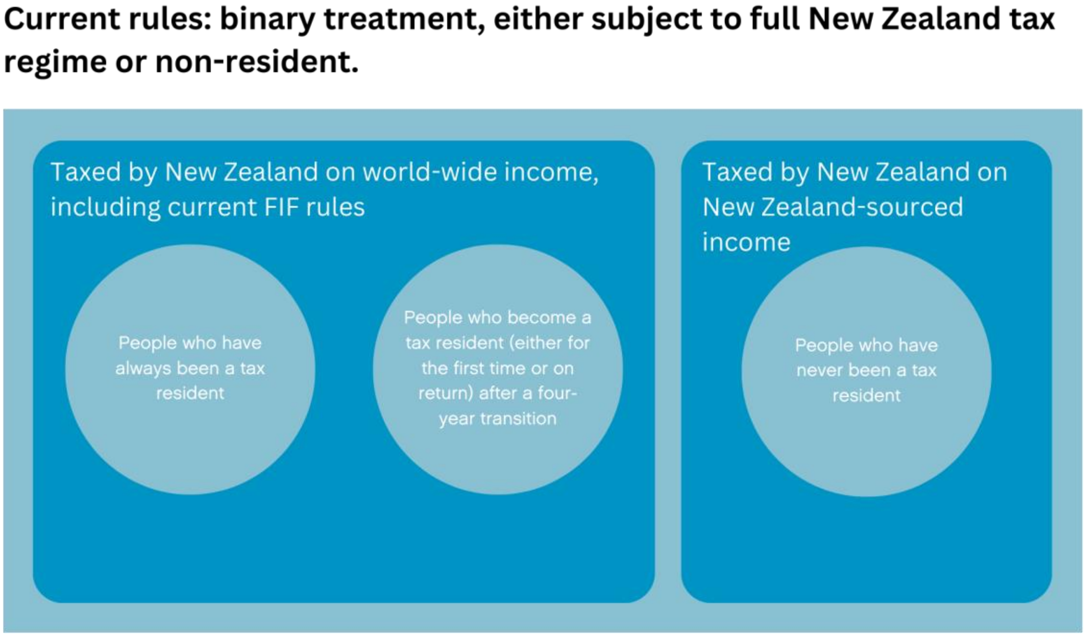
44 James Hines and Larry Summers have argued, however, that the smaller the economy, and the more open it is to trade, the more likely that it will reply on expenditure taxes and less on income taxes (Hines and Summers 2009). This result has been confirmed by empirical studies (Furceri and Karras 2011).

45 Our discussions with people affected by the FIF rules raised other issues that while outside the scope of this report, do warrant further examination. See Appendix D for details.

46 There are transition rules that mean that the FIF rules do not apply till someone has been a resident for four years.

47 GST will also be imposed on their local consumption of goods and services and they will also pay other taxes and charges, such as road user charges.

Figure 8 How our three groups are taxed



Source: The authors

3.3 A brief history of tax policy in New Zealand

As we noted in section 1.2, New Zealand experienced a long period of relative economic decline from the mid-1970s. That decline was accompanied by a significant deterioration in the fiscal position. From 1979 until 1994, the government ran consistent budget deficits, as spending increases outpaced the ability of the tax system to produce revenue. The result was a build-up of government debt.[48] Poor tax policy was partially responsible.

In 1984, the New Zealand tax system was simply no longer fit for purpose. In its Briefing to the Incoming Minister that year, the Treasury said that the principal faults of the system were that it did not raise sufficient revenue and failed when assessed against "any reasonable efficiency and equity criteria" (The Treasury 1984, 210). It recommended significant structural changes.

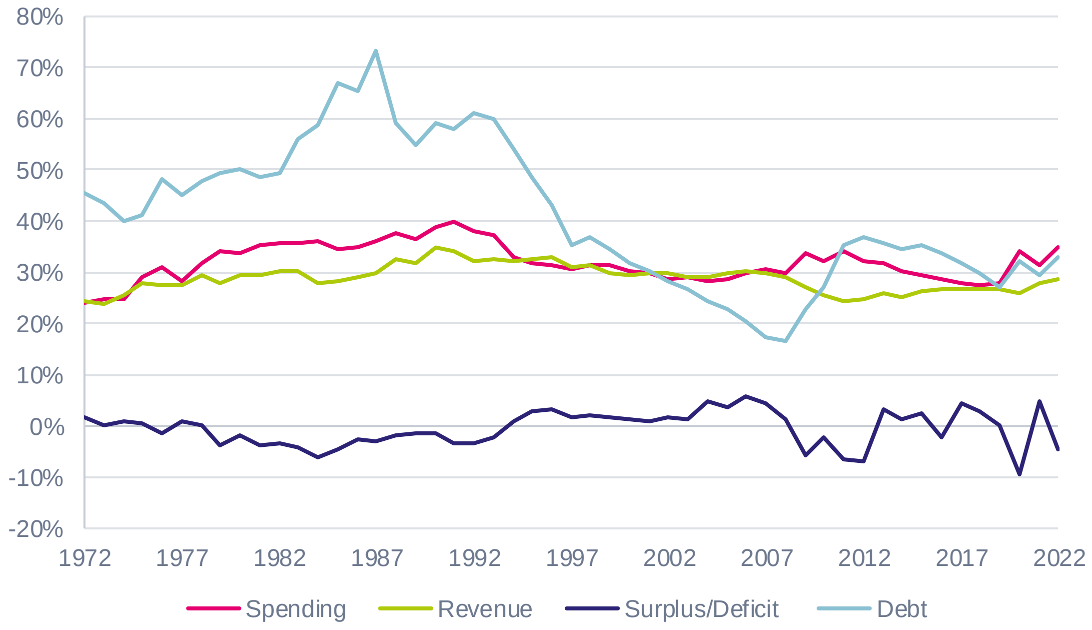
Tax reform from 1986 to 1993 increased the tax-to-GDP ratio, and then from 1991 to 1994, expenditure stabilised. The government finally returned to surplus in 1994.[49]

48 When the Treasury published the first set of consolidated Crown financial accounts using Generally Accepted Accounting Principles in 1994, the government was technically insolvent: liabilities exceeded assets by $3,295 million, about 3.8% of GDP.

49 The reduction in debt from 1987 to 1989 was the result of the proceeds of the sale of government assets being applied to pay off debt.

Figure 9 A perilous fiscal position

Percentage of GDP



Source: The Treasury

The tax reform programme was comprehensive, swift and, above all, highly effective in removing the twin deficiencies Treasury noted. By 1993, the tax system was not only raising the revenue the government needed, but many of the concessions, distortions and inequities that had built-up over decades were swept away. The slogan for tax reform was to move to a 'broad base, low rate' approach.

Major features of the move to this approach were:

- Repeal of many small, ad hoc taxes and charges, like stamp duty and the TV licence fee
- Repeal of taxes that might be justified on equity grounds, but which raised a limited amount of revenue, were costly to administer and were relatively easy to avoid, like gift and death duties
- Replacing taxes on business inputs (like tariffs[50] and the wholesale sales tax) with taxes on outputs (income and consumption), e.g. Goods and Services Tax (GST)
- Progressive removal of tax incentives – departures from treatments applied to sectors or the whole economy designed to promote specific economic developments – and the resulting increases in revenue used to fund across-the-board rate reductions.

Today, the New Zealand government annually raises about $101 billion or 91 percent of total revenue from income tax and GST. Of the remaining 9 percent of revenue, 4.25

[50] While the removal of tariffs was undertaken as part of a trade liberalisation programme and wider economic reform agenda, tariffs had been a major source of general revenue for successive governments. For example, in 1915, customs and excise duties contributed 56.03% of total revenue, falling to a modest 33.26% in 1934 Government Statistician (1935).

percent comes from road user charges and fuel excise, 2.6 percent from excises on tobacco and alcohol, and the remainder from a range of smaller taxes.[51]

Successive governments wishing to change tax revenue have altered the rates of income tax and GST rather than adding or repealing specific taxes.[52]

Since the broad base, low rate was adopted as a guiding principle for tax policy, many reviews of the New Zealand tax system have been undertaken locally and by international bodies like the OECD and the IMF.[53] While these reviews have made recommendations for specific changes to the tax system, none has suggested moving away from the current overall approach.

3.3.1 The centrality of neutrality

One thing that makes New Zealand's tax policy different from that in other OECD countries is that, since 1984, successive governments have not seen the tax system as an instrument for influencing economic activity and encouraging firms to invest in favoured sectors.

> *An efficient tax system would raise the government's required revenue at the least economic cost. In considering efficiency, the impact of policies on the domestic economy as a whole must be considered. In general, the most efficient tax system will be a system that minimises the effect of tax on individuals' decisions. Therefore, in relation to an income tax, efficiency generally implies that all sources of income should be taxed in the same manner. However, this goal needs to be balanced against other concerns such as the compliance costs faced by taxpayers from having all forms of income taxed in the same manner, as well as equity considerations.* (Inland Revenue Department and The Treasury 2003, 8)

When it comes to income tax, the analytical starting point for developing tax policy is the definition of income favoured by economists, called the Haig-Simons-Shranz approach, or 'comprehensive income'.[54] Under this definition, income equals consumption plus net change in wealth. While having clear, practical limits, successive policy reviews have endorsed using a comprehensive definition.[55]

51 Tariffs ($187m), gaming duties ($255m), motor vehicle fees, ($236m), petroleum and mineral royalties ($236m). Approved Issuer Levy and cheque duty ($111m) and energy resources levies ($23m). All figures are revenue raised for the year ended 30 June 2023 (The Treasury 2023b, 68).

52 The exception has been the introduction at various times of regional fuel taxes, especially in Auckland, to fund transport infrastructure.

53 Four major local reviews have been undertaken: The Committee of Experts of Tax Policy (1999), Tax Review 2001 (2002), the Victoria University of Wellington Tax Working Group (2010) and The Tax Working Group (2019).

The OECD has undertaken two comprehensive reviews of the tax system as part of its regular economic surveys: OECD (2000) and OECD (2007). The Economic Department of the OECD published a stand-alone working paper on New Zaland's tax system following the latter review (Mourougane 2007). Successive biennial Economic Surveys of New Zealand by the OECD have also considered tax matters to greater or lesser degree. Reviews since 1975 can be found online at OECD (2024a). Likewise, the IMF's routine consultations with the New Zealand authorities also address tax policy. The IMF's routine consultations with the New Zealand authorities also address tax policy. See IMF (2022).

54 The concept was initially advocated by German legal scholar Georg von Schanz (Schanz 1896) and then further developed by American economists Robert Haig (Haig 1921) and Henry Simons (Simons 1938). For a discussion of the concept, see Atkinson and Stiglitz (2015, 217).

55 As the members of the 2001 Tax Review noted:

We emphasise at this point that the notion of comprehensive income is a theoretical concept that can never be fully achieved under any real-world income tax. Among other things, implementation of a comprehensive income tax would require measuring on an accrual basis the annual change in value of every asset and liability of every taxpayer. Instead, the concept is

3.3.2 Taxing companies

Under a comprehensive accrual-based income tax, companies and other business entities would not need to be taxed, as the undistributed income of a company would be automatically included in the income of its owners.

Real-world income taxes tax companies and other legal entities separately from their owners, with varying attempts to integrate taxation at the entity and individual level. In this paradigm, there are two main reasons for taxing companies. One is an efficiency argument for ensuring corporate form neutrality; the other is about compliance costs.

If companies were not taxed, but individuals were, then there would be a clear incentive to earn income through a company as a way of at least deferring tax.

More generally, if the aim of tax policy is to interfere as little as possible with the business decisions of people, then investments should be guided by business fundamentals, not tax considerations.

The compliance cost argument is that there are far fewer companies than taxpayers, especially large companies with diverse shareholders, such as companies listed on the stock exchange. It is less costly from a national perspective to tax these companies directly and then make some allowance to adjust individuals' income tax when they receive dividends paid out of after-tax income. The cost savings do not just come from one set of calculations being made compared to the same calculations being made multiple times by shareholders. Shareholders will not normally have access to the data needed to calculate their proportion of the company's income.

This information gap between shareholders and companies is a vital issue when taxing New Zealanders' offshore interests, and we will return to it below.

3.4 Reopening a closed economy

Prior to 1984, New Zealand was, to a large extent, a closed economy. While there was some trade in goods and services, it was highly regulated. The exchange rate was fixed (but adjustable from time to time), and rigid capital controls were in place:

> *Foreign reserves were held by the New Zealand Treasury (ministry of finance) and by the Reserve Bank, and were actively used to maintain and manage the fixed exchange rate... private capital flows were tightly restricted, and short-term private capital inflows were largely prohibited.* (Sullivan 2013, 4)

Early reforms removed exchange controls (on 21 December 1984) and floated the New Zealand dollar (on 4 March 1985) (Evans et al. 1996, 1896).

As a result of these reforms, New Zealanders could, for the first time in decades, move capital across the border with little or no official scrutiny. While such reforms represented mainstream thinking at the time, the New Zealand tax system was not ready for this freedom. The result was large-scale tax planning activity that allowed New Zealanders to use overseas structures to reduce the tax burden on their domestic income (Dunbar 2004, 26). The country's tax base was at great risk as a result.

best regarded as a benchmark against which the properties of our income tax, and of potential changes to it, can be assessed (Tax Review 2001a, 30).

It soon became apparent that reform of the international tax system was required. It would, however, take almost ten years of, at times, bitter debate before a political consensus was reached on the appropriate regime.

3.4.1 A simple set of rules for a simple world

Nominally, the pre-reform income tax system did have some of the basic tools needed to tax cross-border incomes.

There were rules for determining who was a resident for tax purposes.[56] Residents were taxed on their world-wide income,[57] with a credit for foreign taxes paid.[58] Non-residents were taxed on their New Zealand-sourced income,[59] with non-resident withholding taxes imposed on interest, dividends and royalties.[60] There was also a limited network of Double Taxation Agreements.

> *Prior to 1 April 1988 New Zealand resident companies and individuals were only liable to pay New Zealand income tax on overseas sourced income if and when they derived it. Taxpayers were not liable to pay tax upon the income derived (and returned) by a non-resident entity, even if that entity was under the complete control of a New Zealand taxpayer and that taxpayer was the only person entitled to receive or use that foreign sourced income.* (Dunbar 2004, 26)

The fundamental issue that the government confronted was that it could not apply the same tax treatment to locals with investments in overseas companies as it applied to investments in local companies.

Figure 10 is a high-level schematic representation of the issue. It shows how a New Zealand resident can be taxed on four separate sources of income.

[56] For individuals, the rule was that a person who had a home in New Zealand was a resident. Companies that were incorporated in New Zealand or had their head office in New Zealand were residents. Section 241, Income Tax Act 1976.

[57] This provision only applied to income earned directly. Section 242(a), Income Tax Act 1976. As we will see below, there was no provision for taxing the income that residents earned from investments in foreign companies that were not repatriated to New Zealand in cash. Indeed, Section 242(c) provided that: "No income which is neither derived from New Zealand nor derived by a person then resident in New Zealand shall be assessable for income tax". Non-resident companies are 'persons' for tax purposes, and thus not a person resident in New Zealand.

[58] There were no credits given for underlying taxes paid at the company level. Only non-resident withholding taxes imposed by other countries were creditable. Section 293, Income Tax Act 1976.

[59] Section 242(b), Income Tax Act 1976.

[60] Part IX, Income Tax Act 1976.

Figure 10 The problem with offshore investments

Source: The authors

If employed or self-employed, they can be taxed on that income as it is earned. If they are employed, their employer can deduct tax under the PAYE system. Self-employed people (including those operating non-incorporated businesses) must pay tax under the provisional tax system.

Interest earned on deposits in a bank account is taxed as they accrue, with Resident Withholding Tax deducted by the bank.

As we discussed above, if they own shares in a local company, the company is taxed on its income as it accrues, and tax is paid accordingly. Shareholders are taxed on dividends but with an allowance for company tax paid via the dividend imputation system. This combined approach means no tax advantage exists between being employed or earning income from leading or owning a business.

However, New Zealand has no legal power to enforce its company tax on companies that are resident in another country. If that country is a tax haven with no or a very low level of income tax, then any company income will not be taxed on accrual. New Zealand can still tax dividends received, but this confers a timing advantage.[61]

The result is that New Zealand residents have a tax-driven incentive to invest in low tax countries.

3.5 The FIF regime

The solution that New Zealand developed for this problem was what is now the FIF regime. In essence, it applies New Zealand tax to the interests that New Zealand residents have in

61 The effect is the same as if the money was held in a bank account with no taxation of the interest as it is earned from year to year, and then withdrawals were included in taxable income. Because the build-up of the amount in the account is accumulating at compound interest without tax, the end result will be higher than if tax were imposed each year.

overseas companies that they do not control.[62] At a very high level of principle, it seeks to replicate the economic effect of the New Zealand company tax/individual tax system on offshore investments.

At a high level of generality that hides a nest of details, the FIF regime taxes New Zealand residents who hold non-controlling interests in foreign companies and other investments.

The FIF regime applies to investments in foreign entities, including shares in foreign companies, units in foreign trusts, and other similar investment vehicles, where those investments are not otherwise exempt. The regime does not typically apply to direct holdings of overseas property or investments in Australian resident companies listed on an approved stock exchange and subject to Australian tax.

Because New Zealand cannot apply the income tax directly to those companies, it has developed a regime that uses the information most taxpayers have to calculate an approximate amount of tax. Taxpayers can, within some restrictions, choose the method that applies to their situation each year. The current methods are:

- Fair Dividend Rate (FDR) This is the default method for many investors. It calculates FIF income as five percent of the market value of foreign investments at the start of the income year plus an adjustment for gains made in buying and selling shares during the year in the same investment vehicle.
- Cost Method: Calculates FIF income based on five percent of the cost of the foreign investments plus an adjustment for gains made in buying and selling shares during the year in the same investment vehicle.
- Comparative Value Method: Calculates FIF income based on the change in market value of the foreign investments during the income year, plus any gains received (e.g. dividends) and costs incurred.
- Deemed Rate of Return Method: Used mainly for superannuation schemes and life insurance policies, this calculates FIF income based on a deemed rate set by the Inland Revenue.
- Attribution Method: Applies to investments in foreign entities that are controlled by foreign companies (CFCs) or foreign investment funds (FIFs) where specific attribution rules apply.

Each method has specific rules, exceptions, and thresholds, including exemptions for small investments (under NZD 50,000 in total foreign investments, not including Australian shares that meet certain criteria).

Taxpayers need to declare their FIF income on their annual income tax return. The applicable income tax rate will then be applied to this income in addition to any other income the taxpayer has earned during the tax year.

There is a special transitional rule for people who become New Zealand tax residents, which defers taxation in New Zealand of almost all overseas sources of income for four years. Our discussion with stakeholders suggests that while it is beneficial for people only planning to remain in New Zealand for less than this period, it is an insufficient period of time to allow many people to dispose of their interests so as no longer to be subject to the FIF regime.

62 There are exceptions, including shares in ASX-listed Australian companies and certain overseas superannuation schemes.

More details of the regime are in Appendix B.

3.5.1 How much revenue does the FIF regime raise?

There is no publicly available data on the number of people paying tax under the FIF rules or how much revenue the government raises from the regime. Nor do we know the likely size of the three groups of people we are focusing on.

We can, however, get a rough appreciation from Stats NZ Balance of Payments Data of the magnitude of the tax base.

Details are in Appendix C.

This data, however, has been collected using a particular methodology (the framework for preparing balance of payments national statistics in International Monetary Fund (2009)) that uses specific definitions of investor, investment and income that are not the same as those used in the tax system. The annual data is also highly variable. Any conclusions drawn from this data need to be treated with care.

The high-level finding is that the level of overseas investment is small compared to total financial assets at the national level. Portfolio foreign investment is, in some years, one-thousandth of domestic investments. This suggests that the current FIF tax base is likely only to make a minor contribution to direct revenue.

While tax data is not available, Stats NZ does publish data on income, which it also derives from its Balance of Payments series. This data is a combination of income from direct investments and portfolio investments. No finer breakdown is available. Specifically, we cannot determine how much income is earned by the members of the three groups of people we are considering. But we do have a geographic breakdown, which shows that Australia and the United States are principal investment destinations.[63]

In 2023, total income from overseas investment was about $13.5 billion.

While very partial, this data suggests that, compared to the domestic income tax base, the FIF investments of New Zealand residents are relatively small. However, the FIF regime was never designed to be a prime source of revenue. Rather, it was designed to protect the domestic tax base from abuse using offshore investment vehicles and remove an incentive to invest offshore. This means that removing the regime for all taxpayers would, indirectly, have a much larger fiscal impact, as people rearranged their investment structures to exploit the loophole this would create. For this reason, we propose retaining the existing FIF regime for people who have always been New Zealand tax residents.

3.6 A brief history

The history of the development of the FIF regime shows consistent themes behind the policy development process that still apply.

The genesis of the current FIF regime was a statement by the then Minister of Finance, the Hon. Roger Douglas, included as part of the 1987 Budget.

The Minister announced the introduction of a regime intended to protect the domestic tax base. The regime was largely focused on anti-avoidance and designed to block the more egregious examples of cross-border tax planning. These measures applied to non-resident

63 Portfolio investment in companies listed on an Australia stock exchange are not covered by the FIF regime.

companies controlled by or trusts settled by New Zealanders in tax havens. They were directed primarily at the use of entities established in tax havens to earn passive investment income and limited types of business income (Douglas 1987, 16).[64]

By December of that year, following further consideration by tax policy officials, the government announced that it had decided on a much wider approach based on efficiency principles. Rather than simply introducing an anti-avoidance regime, the government proposed that residents would be taxed on economic income derived from any interest in a non-resident company or trust.

While protecting the domestic tax base was still an objective of the regime, the government was also looking to increase the neutrality of the tax system with respect to the location of investment:

> *Another objective is to remove artificial incentives for taxpayers to invest offshore. Offshore investment is generally to be welcomed, but it should not be subsidised by ordinary taxpayers. Existing tax provisions are encouraging greater offshore investment than is economically and socially desirable. Hence, the measures attempt to ensure that investment and other decisions are based on commercial merit rather than tax avoidance.* (Douglas 1987, i)

As originally announced in December 1987, all interests would be taxed, regardless of the type of activity, the location of the investment or the degree of control of the level of foreign tax paid. A low-level exemption threshold would apply to natural persons. The tax would be calculated in one of two ways:

- If taxpayers had sufficient information, they would calculate tax based on the activities of the underlying entity (called the 'branch equivalent' approach)
- If they did not have sufficient information, they would be taxed on the annual change in value of the investments (called 'comparative value').

The comparative value approach has proved to be an area of ongoing controversy, particularly because New Zealanders are not taxed on this basis on the shares they own in local companies.[65]

3.7 Why the FIF regime made sense at the time

The FIF regime has always been justified as necessary to promote neutrality in the taxation of residents. In 1991, Ministers said:

> *The objective of the FIF regime, where it applies, is to levy the same tax on the income earned by the FIF on behalf of the resident as would be levied if the fund were a New Zealand company. Because the FIF is resident offshore with no effective connection with New Zealand, the only way of levying the tax is on the New Zealand holder.* (Richardson and Creech 1991, 24)

64 In international tax regimes, a distinction is often made between 'passive' income, which the recipient does not participate in the business activity giving rise to the income, and 'active' income, which does involve such participation (Devereux et al. 2021, 92).

65 But, those companies are themselves taxed separately under the company tax, a point that is often lost. See Figure 10

Four years later, following extensive consultation with stakeholders, Ministers reaffirmed this approach:

> *A fundamental aim of the Government's policy will always be, consistent with meeting other policy objectives, to ensure that, whatever the location of investment or the source of finance, all investment decisions make the most efficient use of New Zealand's resources. Policy that achieves this objective will make the greatest possible contribution to economic growth and consequentially improving living standards for all New Zealanders.* (Birch and Creech 1995, 8)

A major review of the tax system conducted in 2001–2002 examined the FIF regime and its policy rationale in considerable detail; see Appendix B.3.1 on page 51. The Tax Review saw the regime as necessary for preserving neutrality, although they also noted that the design of the regime involved difficult trade-offs.

When reviewing the FIF rules in 2003, officials saw the need for some regime and sought to minimise compliance and administrative costs (Inland Revenue Department and The Treasury 2003, 10).

While the mobility of talented people was occasionally raised, it was normally in the context of not wanting residents to leave rather than considering issues regarding attracting non-residents. In 2003, officials said:

> *If residents were taxed in a way that was particularly onerous in comparison with the taxation of residents of other countries New Zealand residents might leave New Zealand. This limits the extent to which the New Zealand government can tax residents.* (Ibid. 9)

No mention was made of the effect on people wanting to become residents.

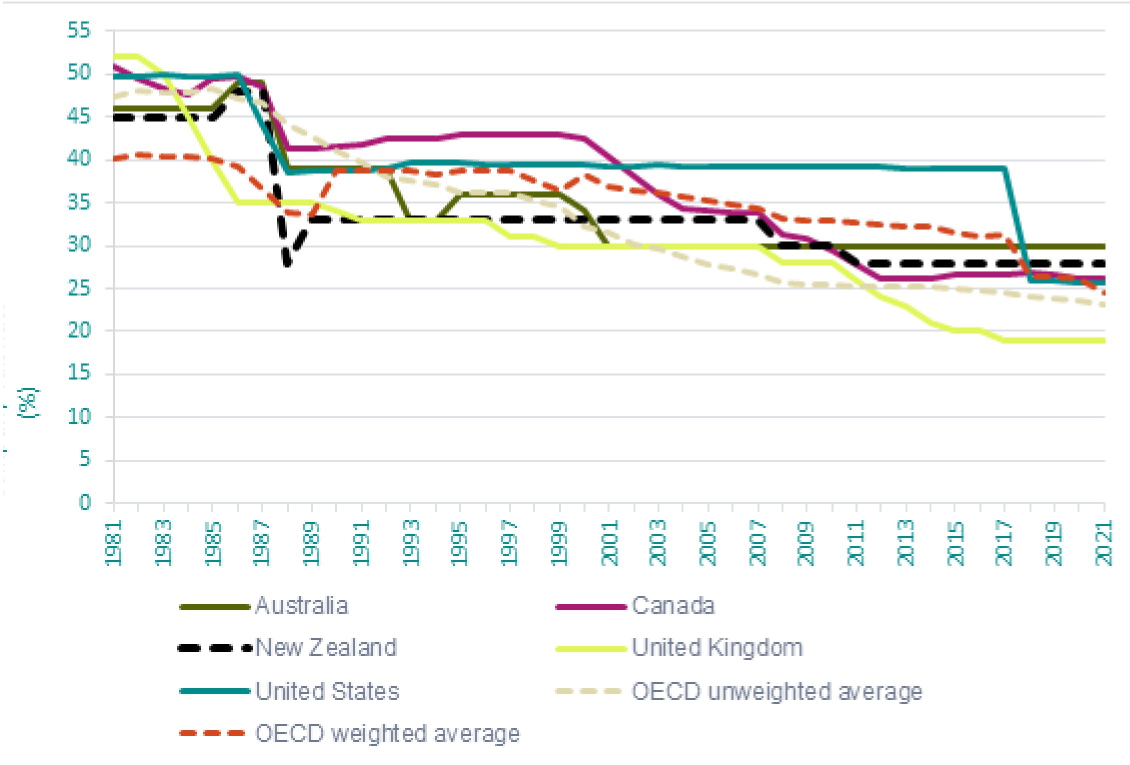
3.8 Avoiding harmful tax competition

The process of globalisation has increased the mobility of capital and labour. At the same time, there has been a downward trend in corporate tax rates (Hines 2005). Opinion is still divided in the academic literature on whether this reduction in tax rates represents a 'race to the bottom', where countries are competing against each other for mobile capital.[66]

[66] See, for example, Desai (1998), Roin (2000), Altshuler and Goodspeed (2003), Altshuler and Grubert (2004), Hines (2005), Roháč (2006), Plümper et al. (2009), Kumar and Quinn (2012), Barrios et al. (2012), Park et al. (2012), Devereux and Loretz (2013), Akcigit et al. (2016), Fischer et al. (2021) and Bharanidaran (2024).

Figure 11 Tax rates have been falling

Company tax rate in selected OECD countries



Source: Inland Revenue Department (2022)

Despite this mixed evidence, policy-makers are certainly concerned about the negative impacts of harmful tax competition and the OECD and the G20 are leading efforts to establish an international minimum rate of corporate tax (Ryding and Voorhoeve 2022; OECD 2024b; A. Kumar 2023).

New Zealand has been actively participating in this and other international programmes for many years (Cullen 2000; Dunne 2013; Collins 2017; Roberston and Nash 2019). Thus, any changes to the international tax rules must be consistent with New Zealand's acceptance of the OECD's work.

New Zealand has generally not engaged in any significant tax competition with other countries. Tax policy has focussed on ensuring that the tax system raises sufficient revenue and does so at least overall economic cost. The level of taxation imposed is largely driven by the level of government expenditure, not by any desire to make New Zealand necessarily more 'attractive' to investment.

> *Weak fiscal states that lack the capacity to raise sufficient tax resources cannot provide adequate amounts of basic public goods that improve worker productivity.*[67] (Dincecco and Prado 2009, 1)

[67] See Hines (2006) for a discussion of the impact of global tax competition on the level of social welfare expenditure.

At an overall level, the New Zealand tax system rates highly compared to tax systems in other comparable countries (Mourougane 2007; Mengden 2023).

3.9 Conclusion

The FIF regime plays a key role in protecting the New Zealand tax base from erosion by international tax planning. It is also a logical extension of the policy paradigm of New Zealand's broad-base, low-rate tax system in that it seeks to remove tax-driven incentives regarding the location of investment by New Zealanders.

But, the consequence of this policy aim is that people who are not tax residents of New Zealand have an incentive not to relocate. This makes attracting the talented people New Zealand needs to prosper harder.

Before we discuss possible reforms, we turn now to the effect that the current rules are having on three groups of interest: returning New Zealanders who have made investments while overseas, highly skilled migrants coming to New Zealand for the first time, and people who are discouraged from spending too much time in New Zealand because of the tax consequences of residency.

4 What this means in practice

The conflict we have examined between immigration and tax policies is not just a theoretical problem; it has profound practical implications. The message from people who are actually or potentially subject to the FIF regime is clear: New Zealand is not a place where most talented people who have been successful in business feel they can afford to live.

New Zealand is a beautiful place, with delightful people and few of the worst elements of modern urban life. But it's still a small country far from the centres of economic power. Wages are low by world standards, and the cost of living is high. Economic research suggests that people will be looking to migrate if they can make a better life overall in another country. This is the centrality of the Callaghan challenge: how do we make New Zealand the place where talent wants to live?

Being a good place to live might be just enough to compensate for low incomes and high costs, but adding a very large tax bill on top of these elements is often enough to tip the balance away from New Zealand for talented migrants and entrepreneurs who would otherwise want to live in New Zealand. Paul Callaghan got it right when he said that these people have choices. Exactly how much do we expect them to give up as they contribute to our national economic and social wellbeing?

4.1 The human element

In preparing this report, we spoke with more than 20 people with connections to New Zealand regarding the impacts of the FIF regime. Most asked that, in sharing their stories, we take care to protect their privacy, out of concerns that there could be negative consequences if they were identified publicly.

Detailed stories from these people are in Appendix D.

To be clear, these are not people who are seeking to avoid tax

They describe themselves variously as being happy to pay tax, coming from high-tax homelands, understanding the social contract, and wanting to ensure New Zealand has the revenue it needs to invest in infrastructure and pay for services.

In most instances, they have retained specialist tax advisers, often at considerable cost, to try to understand and meet their tax obligations. However, due to the complexity of the FIF regime and uncertainty about how it would be applied to their specific situations, very few of our interviewees felt confident that they had a handle on what was required to be fully compliant.

We took care to seek out a wide range of people with different characteristics, including age, gender, ethnicity, country of origin, immigration and residence status (born in New Zealand, born elsewhere, living in New Zealand part-time or year-round, temporarily or permanently, leaving or having left New Zealand permanently).

We also sought people with diverse work and business experiences, from employees with very modest incomes and assets to those who have worked in, founded and advised and served on boards of companies ranging from early-stage startups to billion-dollar household names such as Amazon, Apple and Google.

That said, our sample skews towards the kinds of people who are well-qualified to be among the 100-or-so innovators that Sir Paul Callaghan suggested we need to make a difference to New Zealand's innovation ecosystem and economic success. The vast majority of those we spoke to are currently active, although a couple are thinking of or winding down their active involvement.

4.2 Some recurring themes

We anticipated, given the diversity of their backgrounds and experiences, that the people we spoke to might express varying degrees of connection to our country. This was not the case.

Everyone had a strong commitment to New Zealand

Some were born here, some grew up here, and others first came to the country as adults. All wanted to stay and contribute to helping the country reach its potential.

All our interviewees have the skills, experience or capital that New Zealand needs to boost its productivity performance, in some cases at the individual firm level, and in others through supporting a portfolio of ventures as advisors, mentors and investors. Some people referenced needing to replace Kiwis who had left seeking opportunities overseas. They all had a strong desire to work alongside New Zealanders, both to share knowledge and expertise, and learn with and from them – what is characterised in the economic literature as creating 'spillover' effects – to improve the country's economic and social wellbeing.

Some people arrived in New Zealand with a clear sense of the potential tax implications and others discovered the realities of four-year transitional tax residence and FIF arrangements after they arrived. Almost all described a sense of disbelief when they first understood what these rules involved: "that just can't be right".

The distress that New Zealand's tax rules are causing was palpable

People spoke of negative impacts on their mental health and their family relationships. They feel torn between their desire to live in and contribute to New Zealand, and their inability to make this work financially. In many cases, that is for cash flow reasons, but some people spoke of double taxation being simply unaffordable. This often resulted from New Zealand levying tax on investments that were tax favoured in their country of origin, such as savings for their children's tertiary studies, or retirement savings.

For some people, the fear of being non-compliant and uncertainty over what that could mean was overwhelming. This was despite them spending enormous amounts of time on record keeping, educating themselves, and paying substantial amounts for professional tax advice.

Many people said that, if it were not for the FIF regime, they would be living here more of the time, and in many cases, permanently. Some of the people we spoke to have already left New Zealand because of these issues, and others are debating with their partners and families whether they can afford to stay, a process which is deeply stressful. Others described organising their personal and business lives not around their needs but primarily around the requirements of the New Zealand tax system. This is the very antithesis of the neutrality objective.

These people described themselves as genuinely, deeply committed to New Zealand.

People have changed jobs, left their friends and families behind, bought property and founded and advised companies here. In some cases, they brought beloved pets and put them through a quarantine process that they understood was necessary to protect New Zealand, but that was also long, distressing, and expensive.

4.3 The issues are real

The information we gathered from our extensive discussions with people experiencing firsthand the impact of the FIF rules has confirmed that our analysis of tax and immigration policies is correct.

Our migration system did welcome them. But our tax system did not. While they all aspired to reside in New Zealand, and many had been longstanding permanent residents, most did not want to be a tax resident.

5 A call for action

The conflicts between the objectives of tax and immigration policy need to be addressed urgently.

Very experienced, well-connected, high-calibre people are starting to leave New Zealand as a result, and they are sharing their experiences widely. As people who came to New Zealand during the pandemic begin to approach the end of their four-year transitional tax residency periods, more will be confronted with stark choices between financial manageability and staying in the country they love and want to help succeed. Our tax rules make recruiting top executives and business talent harder.

The current combination of an open regime for skilled migrants and what is perceived as a hostile international tax regime means that New Zealand is not a place where talent wants to live.

The case for reform is, in our view, clear. If New Zealand truly aspires to meet Sir Paul Callaghan's vision, then it needs to bring its tax laws into line with the current reality of an increasingly mobile community of talented people with many alternative choices.

Tax policy has not kept pace with developments in the marketplace for talented people. The days of settler migration – where people left their old homes to settle permanently in a new county from which they and their economic interests would never leave – are over for the world's most talented people.

People with the skills and capital needed to work in, found, advise and support companies meeting the fast-changing challenges disrupting business models and delivering commercial and social opportunities are in high demand globally.

More will come to New Zealand if we truly become the place that talent wants to live, despite our natural disadvantages of size and distance. We should welcome people who are seeking to make the most of what we do have: a beautiful country, full of smart, welcoming people, free of the worst crime and violence and other stresses of modern life in other countries, and open to the opportunities that the ease of doing business here provides.

5.1 Set objectives first

To ensure that any solution is not worse than the current problem, we recommend that the government proceed to address this issue by setting some high-level principles and then assessing the options against them.

We suggest the following principles:

- Talented people should want to come to New Zealand and establish an economic base here, either temporarily or permanently.
- Immigrants and returning New Zealanders should make a fair contribution to New Zealand by paying taxes on their existing investments in a way that is not punitive or so unattractive that they choose to live elsewhere.
- Investments in New Zealand and investments offshore made after people come to New Zealand should be taxed by New Zealand.

- New Zealand should not change its overall policy of not engaging in 'race-to-the-bottom' tax competition, matching concessions offered by other countries.
- The tax system should continue to protect the New Zealand tax base from artificial schemes that allow residents to defer tax on their New Zealand-sourced income by investing in or through low-tax countries.
- New Zealand should not become a haven for unscrupulous activity, behaviour, or individuals.
- New Zealand's reputation for principled tax policy should be enhanced, with third-party countries and international organisations (the OECD, IMF, others) understanding and accepting that any new approach as consistent with developing international norms of acceptable tax practice.
- There is a broad political consensus around any new regime so that potential immigrants have certainty that the regime will endure changes of government.
- The aim should be for the changes to be revenue positive to the Crown.

5.2 Options for reform

Some very important policies are involved and, as we have seen above, inappropriate tax settings can have materially negatively affect both nations (solvency!) and individuals. Developing a simple solution to a complex problem is probably impossible. However, solutions do exist and should be considered.

Conceptually, what we suggest is rather than the current approach, which is described in Figure 8 on page 19 where all residents, whether new, returning, or always born here, are taxed the same way, the government separate the treatment of people who are always tax residents from that of new and returning tax residents.

People who have always been tax residents should be taxed on their world-wide income, as they are at present.

New or returning residents should be taxed on their New Zealand-sourced income but subject to a new regime for their investments made before they came to (or back to) New Zealand.

Non-residents should continue to be taxed by New Zealand on their New Zealand-sourced income.

This new approach is set out in Figure 12.

Figure 12 A new approach

Source: The authors

The simplest way to implement this approach would be to ring-fence pre-existing investments in FIFs and subject them to taxation on a realisation basis (with dividends subject to tax).[68] This is the approach we recommend.[69]

Our recommended approach effectively keeps existing FIF interests outside the New Zealand tax base until they are disposed of. The policy rationale is that New Zealand should not seek to tax on an accrual basis the consequences of investment decisions that were made before the person became a tax resident. However, if income from those investments is repatriated to New Zealand as dividends or gains from sales, then it is appropriate for them to be taxed.

68 In general, dividends from FIF interests are not subject to tax in New Zealand. So, the proposal would be that dividends from ring-fenced investments would be taxed. Likewise, proceeds from the sale of FIF interests are also excluded from New Zealand tax, except in some cases when they are bought and sold within a year. Under the proposal, the gains from sale of FIF interests would always be taxed. This is a departure from the current approach for the taxation of shares held in domestic companies by residents. Under these rules, it is only if the shares were purchased with the intention of sale or as part of a business of trading in shares that gains on sale are included in taxable income.

69 Two other options we considered, but in the end decided did not address the core issue in a simple and effective manner were:

- Introduce one or more new calculation methods for taxing FIF interests that allow taxpayers to voluntarily disclose information about the activities of the underlying economic activity of the offshore company to allow something closer to realisation-based taxation. Our discussions with stakeholders suggest that many of the people we are focussing on would not have access to the type of information required under this option.
- Allow taxpayers to defer the payment of tax on FIF interests until there is a realisation event that provides sufficient cashflow to cover the payment, with interest charged at the current use-of-money interest rates so that the regime does not confer any deferral advantage. While this approach would have addressed the timing issue in relation to the FIF rules, it would not have reduced the economic incidence of the regime.

This is the minimum reform that we consider necessary to align immigration and tax policies. It is self-contained and could be achieved by adding a new optional method of calculation for income derived from the investments in question.[70]

Many detailed policy decisions would need to be made, including whether the new regime applies only to people who enter New Zealand after the date of effect or whether it should apply to some existing or returned tax residents. There is a case for subjecting people who have become tax residents since the onset of COVID-19 to the new regime on fairness grounds (since many made the decision to locate in or relocate to New Zealand very quickly without the opportunity to undertake normal amounts of due diligence regarding the possible tax implications beforehand)[71].

Some wider tax reforms, like more widespread taxation of interests in companies when shares are sold under a capital gains tax (CGT), might allow some relaxation of the FIF rules if they bring the treatment of foreign investments closer to the benchmark of the company tax/individual tax on dividends system. In our view, however, building a political consensus around enacting a CGT that would be comprehensive enough to raise material levels of revenue is a long-term project.[72] Given the immediate impacts of the FIF rules, we, therefore propose that addressing the problem created by the FIF regime should proceed on its own merits now rather than being deferred until wider reforms of the tax system are considered.

5.3 Possible fiscal effects

Our suggested approach will have the following fiscal effects:

- Existing first-time and returning tax residents of New Zealand will no longer be subject to the current FIF rules but will be subject to the alternative regime – this will, at least in the short term, result in a reduction in revenue
- This group of people will be subject to a new regime, which will have a positive fiscal effect.
- Some people who are dissuaded from coming to New Zealand will become tax residents, be taxed on their New Zealand-sourced income and local consumption and will also be subject to the replacement foreign income regime – this will result in an increase in revenue.

It is the combination of the three effects that will determine the ultimate impact on the Crown's finances. The impact of the third group involves measuring the effects of a behavioural change that is induced by the new tax regime. By their very nature, it is difficult to forecast the size of these effects since we have little experience to guide estimation.

70 A variant would be to only apply FIF taxation to new overseas investments made after the date of becoming a resident That is, if a person increases the amount invested in a current FIF interest, then the returns to that increased investment would not be brought into the New Zealand tax base on accrual.

71 An appropriate date would be 16 March 2020, the date on which the requirement for arriving non-New Zealanders to be screen and quarantined came into effect (Cumming 2021, 3).

72 In tax policy, one set of difficult decisions are around the rules that govern the transition from one regime to another. The economics is not simple, see Kaplow and Shavell (2001). In the case of a CGT, how income from existing assets is treated determines how quickly the regime raises revenue. For example, when Australia introduced a capital gains tax, the income from all assets owned on the date of the announcement of the tax was permanently excluded. The result was that it took about 15 years before the regime made a significant contribution to revenue (Inland Revenue Department and The Treasury 2009, 47).

We have no data with which to make any precise estimates of the amounts involved. The balance of payments data suggests that the current base for the FIF rules will likely be small. Officials will have access to confidential taxpayer data that may allow them to confirm our assessment.

The evidence we have gathered from a sample of people potentially impacted by the regime suggests that the third fiscal impact could be large, depending on the New Zealand-sourced income of this group.

5.4 Next steps

As the case for reform is clear and simple reform options exist, we think that there is nothing stopping the government and other political parties in Parliament from quickly addressing this issue. They should work to form a broad understanding that reform is required and agree on what the high-level parameters for any new regime should be. They should also agree that this issue needs to be addressed quickly and can and should be addressed on a stand-alone basis.

Armed with that political commitment, tax policy officials in the Treasury and Inland Revenue, together with immigration policy officials from the Ministry of Business, Innovation and Employment, should be tasked with designing the detailed rules required to implement the proposal.

The aim should be for amending legislation to be announced, consulted upon, and enacted by the start of the 2025 income tax year.

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Appendix A Protection measures

Globalisation and increased movement of people has brought significant benefits to the world's economy and people.

While removing barriers to international trade, commerce, and immigration has opened up numerous opportunities for mutually beneficial exchange, it has unfortunately increased the opportunities available for malicious actors of all sorts.

In response, national governments, international organisations, and civil society have all been assembling various countermeasures.

Along with mechanisms like anti-money laundering rules, policymakers are also aware of the possibilities of abuse that seemingly well-intended initiatives can create.

In this Appendix, we outline several areas where tax and immigration provisions have been targeted for abuse.

A.1 Golden visa and passport schemes

Two common types of schemes that are subject to scrutiny due to concerns about corruption are investor citizenship (golden passports, which involve granting citizenship to a person without a genuine link to a country in exchange for a pre-determined payment or investment) and golden visas, which grant residence under the same circumstances. (European Commission 2019). While such schemes might look attractive, organisations like Transparency International have warned that they have often served corrupt interests rather than promoting the common good (Transparency International 2018).

The European Commission has recommended that all Member States "establish strong checks to prevent security, money laundering, tax evasion and corruption risks associated with golden passports and visas" (Augusto, Bersi, and Pena 2022).

Australia has recently announced the cancellation of its golden visa scheme following concerns about abuse and poor economic performance (Review of the Migration System 2023, 65). In February 2022, the United Kingdom government announced that it was closing one of its golden visas, the Tier 1 Investor Visa, following a review that found "some cases had given rise to security concerns, including people acquiring their wealth illegitimately and being associated with wider corruption" (Patel 2022).

A 2023 joint report by the Organisation for Economic Co-operation and Development (OECD) and the Financial Action Task Force (FATF) discussed the experience of countries in operating Citizenship by Investment (CBI) and Residency by Investment (RBI) schemes.

The report noted:

> *Properly managed, BCI or RBI programmes can, theoretically, benefit both host countries and individuals. However, in practice, such programmes bring significant risks of money laundering, fraud and other forms of misuse, and should be designed and administered in a risk-sensitive way, including by implementing safeguards… (OECD and FATF 2023, 6)*

A.2 Long-established preferential tax treatment

Until reform announced this month the United Kingdom allowed its residents who were born overseas to claim non-domiciled or 'non-dom' status, meaning that their overseas income is not subject to UK tax until remitted to the UK.[73]

One purpose of the regime is to attract talented people to the UK (HM Treasury 2015).

Despite this, the regime has proved controversial, with concerns that it is unfair that one group of taxpayers, who are usually wealthy, can live in the UK and not pay tax on their overseas income, while people born in the UK are taxed on that income (Advani, Burgherr, and Summers 2022, 3).

Successive UK governments have tightened the non-dom rules to reduce the degree of advantage they confer (Seely 2018). The UK Labour Party had promised to repeal the rules if elected in the upcoming election (Thorpe and Crozier 2022). In the UK Budget, delivered on 6 March 2024, the government announced that it would be removing non-dom status in its entirety by 2025 (HM Treasury 2024).

A.3 Money laundering

Money laundering is the process by which money from illegal activities, such as fraud, drug trafficking and tax evasion, is 'cleaned' so that it can be used as legal funds. Money is moved through multiple transactions across a series of institutions and jurisdictions through a process known as layering, which makes it more difficult to discover the origin of the funds. About $1.3 million is estimated to be laundered annually through New Zealand businesses (Ministry of Justice 2020).

Migrant schemes that target potential investors can be abused by people who want to launder funds from another jurisdiction or use the destination jurisdiction as a 'safe haven' to protect their funds from authorities in other jurisdictions. Investing laundered funds in New Zealand, which is generally regarded as a well-regulated jurisdiction, albeit with 'easy' business laws, is a way to add a layer to the laundering process and protect the funds. There are conditions in place for transferring funds under some visa applications that require transferring from a personal account offshore to a personal account in New Zealand (Immigration New Zealand 2024b). This assumes that the 'know your customer' regimes are effective in both jurisdictions.

73 Non-dom statues could also be claimed by people who were born in the United Kingdom to a British father or were British nationals who had lived overseas for a considerable period.

Appendix B International tax principles and practice

This appendix discusses some of the main principles in international tax policy. Then it goes on to describe how those principles have been applied in designing the New Zealand FIF regime.

B.1 Concepts

As the size of governments has increased over time, countries have looked to impose an income tax of some sort to finance their public sectors. And as global commerce, especially foreign investments, has likewise increased, they have had to incorporate tax rules to account for cross-border income flows.

There is no international law of tax – countries are sovereign and can impose whatever rules best achieve their interests – and so practice varies considerably. However, a set of norms were established in the 1920s that are still used.[74]

The OECD and the G20 are currently sponsoring a global work programme on international tax.[75] This is about increasing cooperation with the current framework rather than any fundamental realignment of approach. It is unlikely that any major changes to the high-level structure will occur (Devereux et al. 2021, 106).

B.2 A world of bright lines

The practical upshot of the diverse approach to tax rules is that more than one country can claim the right to tax one person, firm, or transaction. A complicated set of common practices, unilateral measures, and bilateral agreements have resulted in an attempt to address these issues.[76]

Globally, international tax is based on three central concepts:

- residents and source: residence is about where people live; source is about where they earn their income.
- categories of income: with a distinction often made between 'active income', where the taxpayer is involved in the management of the business earning the income and 'passive' or portfolio income, where they are not.
- separate accounting: individuals and the companies they own, and different parts of multinational enterprises are treated separately for tax purposes (Devereux et al. 2021, 89).

[74] While the second world war and its aftermath saw a complete reshaping of global systems of trade (the General Agreement on Tariffs and Trade), the international financial system (the Bretton Woods Agreement that led to the establishment of the IMF and the World Bank) and international relations (the UN), international tax continued to follow pre-war approaches. Even the advent of the European Union, with its principles of freedom of movement of people and capital and regulatory harmony has not encroached on tax policy (Graetz 2001, 262).

[75] Separately, the International Monetary Fund, the OECD, the United Nations, and the World Bank Group have formed a Platform for Collaboration on Tax, which allows for the sharing of experiences: (IMF, OECD, World Bank, UN 2024). For a more general discussion of the issues of international tax co-ordination, see IMF (2022).

[76] There is an enormous literature on international tax, from economic, legal and other perspectives. For a recent summary of developments, see Keen et al. (2019) and Devereux (2021). Michael Graetz provides a general discussion of the historical development of international taxation, with a slant towards the approach in the United States. (Graetz 2001).

While determining whether a person is a resident of one country or two, where income is sourced and which entity in a corporate group earns a particular item of income can be complex, conceptually, the rules involve bright lines:

- you are a resident of a country, and if you are not, then you are a non-resident
- if you are a resident, you can be taxed by the country you reside in on world-wide income
- if you are a non-resident, you can be taxed by the country in which you earn income only on that income.

Figure 13 is a stylised description of the tax bases available to New Zealand under the common approach to international tax.

New Zealand residents can either earn income in New Zealand or offshore. New Zealand can and does tax both sources of income under its income tax. When it taxes foreign-sourced income, it gives a credit against New Zealand for any foreign taxes (up to the level of New Zealand tax). If the New Zealand resident is a company, no foreign tax credit is given for foreign company tax paid.

Non-residents can earn income in New Zealand or elsewhere in the world. New Zealand can and does tax the New Zealand-sourced income of non-residents, with several exceptions and qualifications. However, New Zealand cannot enforce its tax laws on non-residents of New Zealand who earn income overseas.[77]

Figure 13 The tax bases available to New Zealand

	Resident of New Zealand	Non-resident
New Zealand-sourced income	Directly taxable by New Zealand	Directly taxable by New Zealand (with other country giving foreign tax credit)
Foreign-sourced income	Directly taxable by New Zealand, but required to give foreign tax credit	Outside the New Zealand tax base

Source: The authors

A New Zealand resident can exploit this inability to reduce their New Zealand tax liability if they incorporate or invest in a company located outside New Zealand. The income that this company earns is outside the New Zealand tax base. This is the purpose of the FIF rules.

77 The United States does impose tax on the foreign sourced income of its citizens who are not tax residents. It can do this because many people value their citizenship highly and are thus willing to comply with the reporting and payment requirements.

B.3 Practice: The FIF regime

We now turn to the history of the FIF regime since it was first enacted in 1988, as well as its current features.

B.3.1 History

Legislation to introduce the regime was passed in 1988, with an effective start date of 1 April 1990. The new National government announced in March 1991 that the commencement of the regime would be deferred to 1992, pending a review. It published a framework document setting out its thinking on international tax issues (Richardson and Creech 1991).

Following extensive consultation, an amending Bill was introduced into the Parliament in 1993 that would finally bring the regime into effect, applying to all interests in a FIF held on 1 April 1993.

The regime applied to non-controlling interests in foreign entities (foreign companies and unit trusts and interests in foreign superannuation schemes and foreign life insurance) that are resident outside a list of six high-tax countries.[78]

The enacted regime gave taxpayers a choice of four methods by which to calculate their tax liability. These options were:

- Branch Equivalent, which is an exact calculation of a FIF's income or loss under New Zealand tax rules but was restricted to interests in companies.
- Accounting Profits, which allowed taxpayers to base their New Zealand income tax liability on the net after-tax accounting profits of the FIF[79]
- Comparative Value, where there is a change in the value of a person's interest in a FIF, is used as a proxy for the underlying income accumulated by the FIF.
- Deemed Rate of Return, where the value of FIF interests is multiplied by a rate of return set annually.

A major review of the whole New Zealand tax system was undertaken in 2001 and 2002 by an independent panel of experts, assisted by a secretariat of officials. They published an issues paper and sought submissions before delivering a final report.

The Review spent considerable time and effort examining the issue of the taxation of FIF interests. It identified the key issue as the tension between two desirable objectives:

- "the New Zealand tax system should not result in a lower aggregate tax burden (foreign tax and New Zealand tax) for offshore investment than New Zealand investment. … This suggests taxation in New Zealand of offshore income as it accrues, regardless of the source of the income or the nature of any intermediary entity that derives it"
- "resident companies and individuals who wish to invest offshore should not be forced to question whether they should remain resident in New Zealand by virtue of a

78 Australia, the United Kingdom, Canada, Norway, the United States, Germany and Japan.

79 This method was only available if the FIF was listed on a stock exchange and prepared audited accounts using generally accepted accounting principles.

significantly higher burden of New Zealand tax on offshore investment than the range of standard international practice in other countries" (Tax Review 2001b, 87).

Notice that the Review did not mention the issue of New Zealand's attractiveness as a destination for immigrants.

In the end, the Committee could not reconcile those objectives and thought that they might not be largely irreconcilable.

> *On the one hand, New Zealand does not want to induce our most mobile taxpayers to consider moving from New Zealand. On the other hand, New Zealand does not wish to adopt a built-in tax incentive that causes people who remain in New Zealand to see a tax advantage in investing offshore rather than in New Zealand. But, it is precisely this type of system, that produces a tax incentive to invest offshore, that is the international standard.* (ibid. 88)

As a compromise, the Review recommended that:

- New Zealand should continue to tax FIF interests
- The 'grey list' should not apply to FIFs
- A new method, called the 'Risk-Free Rate Method' (RFRM), should be used to calculate income
- A person with no previous connection to New Zealand should only be taxed on their New Zealand-sourced income for seven years
- The tax imposed on a single individual in any year should be capped at $1 million, because "People earning income at these levels are of critical importance to New Zealand as a result of their international connections and ideas" (ibid.).

In its Issues Paper, the Review proposed the RFRM was a way of addressing the major gaps in the New Zealand tax system: the exclusion of owner-occupied housing and the limited taxation of capital gains. As the review explained it:

> *The tax base under the RFRM is the amount that would have been earned if:*
>
> - *The funds invested in an asset subject to the regime had instead been invested in a risk-free government bond; and*
> - *the portion of the return on the bond that represented compensation for inflation was exempt from tax.* (Tax Review 2001a, 35)[80]

Under the RFRM, a taxpayer's liability was calculated by multiplying the value of a person's net assets at the beginning of the tax year with an inflation-adjusted risk-free interest rate (basically, the interest rate on government bonds less the inflation rate).

Figure 14 shows the historical level of the risk-free rate in New Zealand since 1990. It is currently negative, given the high inflation rates. As we will see below, the Review idea of a risk-free rate has been translated into a fixed percent rate over time.

80 This idea was based on a system used by the Netherlands at the time for taxing interests in owner-occupied housing.

Figure 14 Real risk-free interest rates in New Zealand

Secondary market government bond yields for ten-year government bonds, less CPI inflation

Source: Reserve Bank of New Zealand

The government ruled out applying the RFRM method to housing after the publication of the Issues Paper, so the Review did not pursue that proposal. The Review did, however, propose that it be applied to FIFs.

The government of the day did not immediately respond to this recommendation. Rather, it asked officials to consider the matter further.

In a 2003 discussion document, after discussing differing objectives like those raised by the 2001 Tax Review, officials concluded:

> *These constraints imply that the practical approach to the taxation of offshore investment is to design rules that attempt to minimise the influence of tax on the decision of whether to invest domestically or offshore and on the decision of where to locate offshore investment. Such rules would provide income calculation methods that represent a reasonable approximation of how similar investments are taxed domestically, while minimising the compliance costs associated with calculating income.* (Inland Revenue Department and The Treasury 2003, 10)

To this end, they proposed what they called a new "standard return rule" for taxing FIF interests:

> *A standard return rule is a method to determine taxable income for certain non-controlled offshore investments in equity. The rule would operate by applying a statutory rate of return to a qualifying asset's value at the beginning of an income year to determine the taxable income for that asset. Any returns from the asset, such as dividends or capital gains, would not be subject to tax*. (Inland Revenue Department and The Treasury 2003, 20)

They further suggested that a real risk-free rate of 4 percent should be used.

This approach would apply to all non-controlling interests expected for shares in listed companies in Australia (ibid. 51).

They did not discuss the Review's other recommendations: the seven-year window or the $1 million cap.

These proposals were eventually accepted and formed the general basis for the current regime.

B.3.2 The current regime

In summary, under the current regime, a FIF is:

- a foreign company, including a foreign unit trust
- a foreign superannuation scheme
- an insurer under a life insurance policy (if it is not offered or entered into in New Zealand).

Interests in companies listed on the Australian Stock Exchange are exempt. If a person has more than a 10 percent income interest in a foreign company controlled by New Zealanders, they are subject to a different regime (the Controlled Foreign Company regime).

There is a general $50,000 threshold.

There is a one-time, four-year transitional period during which people becoming tax residents of New Zealand are exempt from the FIF regime.

There are now five different methods that can be used to tax:

- Fair dividend rate (FDR) – which is based on officials' 'standard return rule'. However, rather than being based on an inflation-adjusted risks-free rate of return, a five percent rate is used. Income is thus five percent of the opening market value of the person's interests in foreign companies. Dividends and capital gains are not usually taxed separately.
- Comparative value (CV)
- Deemed rate of return (DRR)
- Cost method (CM) – similar to FDR but applies where no market value of interest exists.
- Attributable FIF income method (derived from the original Branch Equivalent method).

Appendix C Data

This Appendix contains the detailed data on overseas investment and income that we have used to indicate the likely size of the FIF tax base.

C.1 Investment

Stats NZ publishes data on investments abroad as part of the balance of payments series and on total investments as part of the national accounts.

Table 1 shows the total for overseas direct and portfolio investment and total financial assets for comparison. Total financial assets are not directly comparable to the overseas investment figures, but they do indicate relative size.

Table 1 Investment overseas by New Zealanders

Millions of NZ dollars

Year	Direct investments	Portfolio investments	Total financial assets
2000	2,216	2,500	
2001	-9,111	4,655	
2002	77	3,453	
2003	1,896	635	
2004	1,943	260	
2005	1,481	1,042	
2006	-2,679	-500	
2007	396	4,600	2,079,598
2008	7,307	1,930	2,241,596
2009	-978	-3,690	2,329,089
2010	-2,864	7,514	2,335,719
2011	1,271	784	2,437,155
2012	-1,029	2,849	2,458,671
2013	-20	5,894	2,517,015
2014	-994	7,448	2,602,075
2015	1,411	11,410	2,817,461
2016	995	4,829	2,966,243
2017	-1,151	10,081	3,124,974
2018	-1,804	4,705	3,315,669
2019	737	5,384	3,531,927
2020	-812	-5,968	3,733,707
2021	1,305	30,139	4,068,555
2022	-1,616	1,732	4,441,223
2023	548	4,318	

Source: Stats NZ

There are a number of observations we can make:

- The data on overseas investment is highly volatile. This suggests that revenue from taxing overseas investments is also likely to be volatile, depending on the method of calculation used.
- There tends to be a higher level of portfolio investment, compared to direct investment, although again, within a volatile series. This suggests that taxation under the FIF regime is likely to raise more revenue than the regime for taking direct overseas investment (the CFC regime)
- Overseas investment is tiny compared to local investment. In 2021, the year with the highest level of overseas investment in the data series, total overseas investment was only 0.77 percent of total financial assets. This suggests that the FIF regime will be making a commensurately tiny contribution to the tax take.

C.2 Income

Data on income earned on overseas investments come from balance of payments data.

Table 2 shows the total amount of income earned by New Zealanders overseas since 2001. This is a combination of income from direct investments and portfolio investments. No finer breakdown is available. Specifically, we cannot determine how much income is earned by the members of the three groups of people we are considering (returning residents, newly arrived residents and people who are currently spending less than 183 days in New Zealand). But we do have a geographic breakdown, which shows that Australia and the United States are principal investment destinations.[81]

Table 2 Income from foreign investment by New Zealanders

Millions of NZ dollars

	Australia	UK	USA	RoW
2007	1,237	213	594	3,046
2008	1,257	289	740	4,686
2009	784	67	670	3,215
2010	772	126	489	2,749
2011	698	124	610	3,076
2012	1,246	110	450	2,995
2013	1,240	216	494	3,197
2014	1,145	205	625	3,338
2015	1,656	229	649	4,134
2016	1,853	164	903	4,788
2017	2,091	240	1,026	4,920
2018	1,962	106	1,101	4,682

81 Portfolio investment in companies listed on an Australia stock exchange are not covered by the FIF regime.

	Australia	UK	USA	RoW
2019	1,758	429	1,454	5,665
2020	1,516	335	1,416	5,166
2021	2,252	120	1,731	6,086
2022	2,787	215	2,069	7,457
2023	3,064	226	2,239	8,081

Source: Stats NZ

Observations from this data are:

- the data is less volatile and shows a steady pattern of increase through time
- while Australia and the United States are large sources of income, the rest of the world dominates[82]
- when combined with the data on investment totals, overseas investment does appear to deliver high returns.

82 While not presented here, the data series shows that investment in the rest of the world is spread over many countries, one of which is significant.

Appendix D In their own words

In this Appendix, we share some of the stories we were told. We have removed identifying details to protect people's privacy. The names we use are all pseudonyms.

D.1 What people expected in New Zealand

Many people we spoke to came to or returned to New Zealand expecting to trade off lower salaries and higher living costs for a much better quality of life. It was only when the tax consequences of their relocation decisions became clearer that they began to reconsider whether this would be manageable financially.

> Lila Harris initially came to New Zealand due to COVID and decided to stay. Lila is an executive at a tech firm, helping many Kiwi start-ups accelerate their growth by implementing global best practices learned from her 20 years in the world's top tech markets.
>
> She and her partner want to stay in New Zealand, and use their skills to grow the tech sector, helping it to become one of New Zealand's primary economic drivers. They also want their kids to grow up here.
>
> Lila describes her day-to-day life in New Zealand as idyllic, but she and her partner are on the cusp of making a decision to leave due to FIF. Having worked extensively in tech, Lila has numerous options that at some point will trigger FIF liabilities that are simply not financially viable to meet.
>
> Lila does not come from a wealthy background and financial security is important to her. Her salary is significantly lower than she received at home, and her opportunities to invest and grow her savings are greatly reduced. Paying a 5 percent FIF penalty every year limits her ability to invest in her family's future. She and her partner also cannot put money in investment vehicles that grow over time in ways comparable to the US (which offers numerous tax preferred vehicles such as those related to college savings, retirement income). Investing in the New Zealand market is not an answer either, as it does not produce comparable returns and subjects US citizens to Passive Foreign Investment Company (PFIC) rules. Lila is concerned that her choice to stay in New Zealand is limiting the future financial security of herself and her children.

In some cases, people have sufficient assets to meet any tax liabilities, but accessing the necessary cash flow to meet these obligations is problematic. This can be because savings are locked up in vehicles that were not intended to be accessed until much later (such as savings for retirement or tertiary study).

> Maya Zhang moved to New Zealand from the United States two years ago with her husband and children. She loves her job and earns a modest salary by New Zealand standards. Based on her overseas experience, Maya has introduced innovative processes and practices that are highly valued by her employer.
>
> Maya and her husband want to stay in New Zealand and buy a house, but they feel overwhelmed by tax complexity and uncertainty. They have engaged two professional tax advisers to help them understand the rules but still feel as if they are in limbo. They are scared to invest in anything because the tax implications are unclear. As it is, on top of paying New Zealand taxes, and US state and federal taxes, they are also being

taxed on their retirement savings and their children's college savings, both of which would be tax-free in the US.

Samantha Lawson moved back to New Zealand after 20 years employed in senior roles in technology companies. Her compensation was reduced by about 70 percent when she relocated. Sam was prepared for that and did not mind, given the benefits of a New Zealand lifestyle.

She invested her US earnings in conventional stocks and index funds and is a strong believer in paying tax, but double taxation in New Zealand was untenable: "We all know that New Zealand has higher income tax rates than, say, the US. That's just part of the social contract of being in New Zealand and the safety net and benefits afforded to residents. I am fine with higher taxation, it's double taxation which is difficult to accept".

Sam was paying NZ tax on her New Zealand salary and had planned to pay capital gains in the US when she pulled out savings from the stock market. She had budgeted for that but had not planned for another five percent on top when the FIF tax kicked end at the end of her transition period. Sam describes a constant fear of not being tax compliant despite getting expert tax advice and spending enormous amounts of time on compliance. Having returned to the US has lifted an enormous weight from her shoulders.

Sam says that many people she knows are structuring their relationships with New Zealand in a way to ensure they do not have to fall into the NZ tax net at all due largely to not being willing to pay both FIF and capital gains tax: "There are people who get permanent residence because they want to live here but then only stay 3-5 months a year as they don't want to deal with FIF." As a consequence, New Zealand is losing out on tax revenue: "Without FIF many more people would fully commit to being here permanently and would essentially switch the majority of their tax burden into New Zealand."

Victor Saxton is a New Zealand-based software engineer. He has around NZ$200k invested offshore in publicly listed companies. He pays FIF tax on these – having educated himself and paid several thousand dollars for tax advice – and is confident he is compliant. Because these assets are liquid, he can sell small amounts to pay his tax liabilities. However, he cannot easily do this for the numerous earlier-stage startups that have compensated him through a combination of a base rate/salary and options.

When he changes jobs, as he does reasonably regularly, Victor often has to exercise or lose options. If he exercises them, he is on the hook for FIF tax, but a) might not know their value (as a minor shareholder, he might not be told), b) might need board approval to sell them, or c) might not be able to sell them at all.

Victor worries about his New Zealand-based staff, who are even worse off. On much lower incomes, they cannot afford tax advice, and many 'wing it'. Some don't understand what is going on and are likely to be non-compliant. People in the sector share advice "by the way… if you have holdings in Sharesies worth more than $50k…" via word of mouth, but the whole situation is awkward.

Skye Campbell and her husband moved to New Zealand on critical purpose visas in 2020. They packed everything, including their cats, and came here intending to stay.

They decided to relocate with their eyes wide open and were well-informed about FIF rules and consequences.

They are getting ready to leave New Zealand before they reach the end of their four-year transitional residency period because "the bar to stay is so freaking high". Despite being on relatively good salaries by New Zealand standards, they have not been able to save as much as they would like for the future, especially since they can't participate in Kiwisaver due to US taxes. The factors contributing to their decision to depart include better work opportunities at home, a desire to start a family, and their ability to save for a deposit and purchase a home and save for their children's education. There are also significant risks to their retirement savings, both because of their inability to save and the need to pay taxes on unrealised gains.

Staying would involve such a massive restructuring of all their financial arrangements that they would need to commit to spending the rest of their working lives in New Zealand… and career opportunities outside the country are better. They are very happy to pay taxes in New Zealand and would happily pay tax on realised gains, but paying tax on non-realised gains or gains that are never realised is a different story. Skye says, "I can't do that for money I don't even get, especially not when I would get no credit for having paid it and would need to pay tax on it again in the US".

For several people we spoke to, both liquidity and perceived fairness were issues:

Rachel Smith and Daniel Vaughn have lived in New Zealand, the United States and the United Kingdom. They intended to return, contribute their skills to boards, and act as advisors and investors. They bought land pre-COVID, returned to build a house, and discovered FIF. Rachel and Dan knew and were fine with Double Tax Agreement (DTA) arrangements and expected to pay tax in exchange for the honour of living in New Zealand. They believe in the social contract and understand what is needed to maintain a solid tax base, invest in infrastructure, and take care of others. However, paying a deemed return on unrealised gains is punitive.

Rachel and Dan have engaged a tax adviser and are considering selling their land and moving back offshore. They would need to work another 10–15 years to pay these additional taxes on volatile assets. This is both a liquidity issue and a moral one – it doesn't feel morally right to pay tax on gains you may never see.

Dominic McLeod has longstanding family connections with New Zealand, and his wife attended school and university here. After spending time abroad, he now works in New Zealand. He is also a mentor and investor in the NZ ecosystem. Both Dominic and his wife work for a salary and are not very wealthy. They would like to live here because of their strong ties to New Zealand, but they have mutual fund investments in the US, and the tax implications are significant. Essentially living in New Zealand means paying a FIF tax on unrealised income without any credit for payments made. Dominic is happy to pay taxes, just not twice; hence he and his wife are starting to discuss, "is this the right place for us?"

This is particularly the case when trying to do the right thing in multiple tax jurisdictions, which would lead to both increased complexity and significantly greater costs due to double taxation.

Rohan Sharma and his wife are both EHF fellows. They have a longstanding connection with New Zealand, with their earliest business interests dating back to

2009. They are on track to get permanent residence and want to give back to New Zealand, but they are unsure whether they ever want to be tax residents. They come from a high-tax US state and are comfortable paying tax. However, they have significant illiquid assets in the US and elsewhere that are hard to value and have not yet produced any realised income. They fully expect to pay US capital gains tax on these assets when they liquidate them, but they intend to liquidate these assets at retirement, when their income tax rates will be lower. If they become tax resident in New Zealand, they will have to sell these assets earlier to pay FIF taxes. They will then have to pay US CGT on realised earnings much earlier than they had anticipated… and, simultaneously, receive no credit for tax paid in New Zealand from the US tax authorities, effectively meaning they are taxed twice. This feels deeply unfair and inconsistent with New Zealand's purported values around fairness.

In other cases, even if people wanted to access illiquid assets to pay their New Zealand tax liabilities, they may be unable to do so. This is often the case when someone has been a founder or early employee in a company that achieves considerable success: a situation where illiquidity is a feature, not a bug.

Brandon Laval arrived in the country on his own as a teen. He describes himself as a proud adopted son of New Zealand. He has lived abroad, including in Australia, where he was an early employee of a company that is now valued at more than NZ$40 billion. Brandon has substantial illiquid investments in this company. He hopes to be able to access liquidity in time to meet his New Zealand tax obligations, but he may not be able to. He is currently going through his four-year transitional tax residence period. Since returning, Brandon has established a successful startup accelerator and investment firm and works on various social and community projects.

This applies to locals and returning New Zealanders as well.

Arjun Patel's current startup is valued at just under NZ$200 million. Based on his ownership share, he is liable for about a million dollars' worth of tax every year, but his holdings are nowhere near liquid enough to manage that.

In many cases, Kiwis who have been successful overseas and are committed to giving back and helping others achieve similar results are finding their efforts hamstrung by the tax regime.

Keith Daniels left New Zealand for the United States, always intending to learn how to become an entrepreneur and then return home to teach others these skills. He founded a successful company valued at more than NZ$400 million, headquartered in the US. He is contractually bound to maintain an ownership share in his company until it is listed publicly.

Keith wants to return home permanently with his partner and young family, but liquidity constraints mean New Zealand tax residence would be unaffordable. There is no way he could cover his FIF tax liability using a New Zealand salary, and he does not have access to other sources of cash. The family are bracing to leave the country permanently – even though their families are in New Zealand and the lifestyle is everything they want – to pre-empt exposure to FIF tax.

Marcus Walker has co-founded several successful companies and spent several years in New York after leaving New Zealand. He returned home with his wife and young family at the start of the pandemic. They were effectively locked into the country, which led to a change in their tax residence.

Marcus wanted to set up a go-to-market venture capital fund to help Kiwi companies enter New York, essentially putting investor money into the US market. This proved to be unworkable, and the attempted workarounds he examined were just too difficult.

Marcus has spoken publicly about how the New Zealand tax system does not work well with the reality of how startups work and create value. For example, paying stock options is standard protocol in the US: it means that both staff and owners benefit when the company succeeds (as was the case when Rocket Lab went public and created 100 millionaires).[83]

Statistically, probably 95 percent of startups fail, and that is factored into the business model. People accept that, but paying tax on unrealised gains and receiving no tax credit for that payment in the US is untenable.

Most people can't afford to pay this much tax on New Zealand salaries. Even if they can, the compliance issues are difficult. Often, minor players (such as angel investors or those with 'sweat equity') may not have access to valuations because they are market-sensitive or not available with sufficient frequency. Liquidity is often tied up for sound business reasons, including ensuring founders remain committed to a company for a specified period.

Marcus is an absolute believer in paying tax on realised gains. New Zealand needs investment in education and infrastructure, and tax pays for that. But as it stands, New Zealand is driving away talent and investment that can't afford to pay tax upfront – which means we miss out on all three.

Some of the people we spoke to arrived somewhat spontaneously during the COVID-19 pandemic. Those who came as migrants are grateful for the 2021 visa arrangements that enabled them to stay, and many have been making significant contributions as founders, investors, advisors and mentors. However, some of these people did not realise the FIF implications of their decision to stay until well into their four-year transition period. They are facing some particularly unpalatable choices.

After a successful career in a well-known US company, Darius Hart says he is in denial.

Darius is a founder at a major New Zealand startup and has raised funding from overseas investors bringing those funds and connections into the New Zealand economy. Additionally, Darius's startup is poised to begin exporting millions of dollars worth of product from New Zealand, bringing more capital into the New Zealand economy.

Darius says that his salary and compensation is a fraction of what it was in the United States, but it's worthwhile due to his love for New Zealand and the work that he is doing here. Much of Darius assets are overseas though, wrapped up in equity from his previous work. "FIF Tax essentially wipes out most of what I make in New Zealand - I am basically working for free which is unsustainable".

83 This is another example of a wider issue that should be considered further.

Moving his US assets to New Zealand makes no sense – there would be a high transition cost, and there are insufficient vehicles to invest in (relative to the US, the New Zealand equity market is unattractive). Reflecting on his current position, he said, "New Zealand salaries don't justify these financial decisions; you have to be here for another reason. The financially responsible decision would be to return to the US."

Darius says that staying in New Zealand will not be tenable long term for him and his family with the current taxation arrangement.

D.2 Arranging lives around the tax system

Ironically, given the expressed intent of New Zealand's tax regime is to support neutrality (see section 3.3.1), many people arrange their lives around the tax regime, limiting the days they spend in the country so as not to trigger a change in tax residence. This is not due to a lack of willingness to pay tax. It simply reflects the reality of how startups operate and the resulting illiquid investment portfolios.

Xavier Fitzgerald carefully tracks how many days he can be in the country in his online calendar. This is constantly getting in the way of the mentoring and advisory work that he wants to do – but he doesn't have sufficient liquid assets to pay FIF taxes. The nature of his business is such that most of his funds are reinvested in early-stage and illiquid business assets, and he cannot cash out.

Ethan Graham has made enormous contributions to New Zealand business over many decades in ways that would make him immediately identifiable if we listed them here. He has sought professional tax advice in his country of origin and New Zealand, along with independent third-party advice, and he is still unsure about the rules. Ethan and his wife have been New Zealand permanent residents for years, but they are scrupulously careful to avoid becoming tax residents, not because they don't want to pay taxes but because they are not clear about the financial implications. Their personal location and business decisions are driven primarily by tax considerations. Ethan has stepped away from a number of recent business opportunities that were otherwise attractive due to uncertainty around their New Zealand tax implications.

Dominic McLeod, whom we met earlier, knows many people who spend no more than five months a year in New Zealand. We benefit from GST on the goods and services they consume, but they would make a much bigger contribution to the economy and the tax system if they lived here year-round.

Victor Saxton, whom we also met earlier, believes that there may come a point where he is so asset-rich and cash poor that he needs to become a tax resident somewhere else to remain liquid. He says, "This is not about not wanting to pay tax. I'm happy to pay tax. This just makes it impossible".

In each of these instances, and in many more not included here, New Zealand would be better off if people could organise their activities based on their work, business and personal requirements rather than those of the tax system. We would have greater access to talent, investment, mentorship and advice, experience greater 'spillover' effects, and bring in significantly more tax revenue.

D.3 The rare situations in which this is manageable

Those people who have been able to work within these arrangements without finding them overly onerous share some common characteristics: their asset holdings tend to be more liquid, and their net worth allows them to access extensive top-level tax advice.

> Nathan Masters lived in the United States for 12 years, married a US citizen and became a US permanent resident. His desire to live in New Zealand and raise his kids here was an additional, non-financial, factor in his calculation when he decided to expatriate to New Zealand. This involved paying mark-to-market taxes on unrealised gains. After being involved in startup activity for over 20 years, his portfolio includes many early-stage, long-term, and illiquid tech investments. He decided that on a portfolio basis, paying tax on 5 percent deemed income was the lesser of two evils. While he sees the challenges associated with paying taxes on investments that may generate no income or dividends, and on returns that have not and may never be realised, and receiving no tax credits on losses, across his portfolio, he hopes he will be better off than he would be ultimately paying US capital gains tax on highly successful outcomes. While it is "quite inane, illogical and painful" paying tax on investments that subsequently become worthless, and Nathan may have to use hard-earned liquidity to pay this tax liability, he acknowledges that many – perhaps even most – people may not have this option.

It also helps if they are approaching or already at the point where they are winding down their entrepreneurial activities.

> Wyatt Briggs describes himself as very lucky. As his career in very senior positions in major technology companies around the world drew to a close, he decided to move to New Zealand permanently. He spent a great deal of money on tax advice and leveraged his relatively liquid asset holdings to pay his required FIF contributions.

At the other end of the spectrum, there are people who are much earlier in their entrepreneurial careers. Even if they have done well, they still need to manage their resources carefully. Provided enough of their assets are liquid, they may be able to consider relocating.

Caleb Stewart is contemplating giving up US citizenship and moving to New Zealand, where the absence of a capital gains tax is very attractive. He is happy to pay tax on any income he generates once he has moved to New Zealand, and because he has liquid cryptocurrency assets, he believes he will be able to meet his obligations under the FIF regime. However, because of a significant portfolio of US based investments including ownership in his current US based company, he is concerned about the potential tax liability. He can afford specialist tax advice to guide him through this process.

D.4 A place where talent doesn't want to live

> Rachel Smith and Daniel Vaughn, who we met earlier, describe the FIF regime as an actual material encumbrance to bringing in and keeping the talent New Zealand needs to thrive (including medical, technical, financial and energy specialists) and address structural weaknesses of our economy. Even worse, because our best and brightest tend to go overseas (because New Zealand has a small population with limited opportunities), we need to replace them.

The US is awash with private investors who are disincentivised to live and invest in New Zealand: “no one in their right mind would do this financially” (that is, be taxed twice on unrealised income and get no credit for it). The general feeling that comes across to many potential migrants is, “we’re so wonderful we can extort you”. F and G have lots of friends in the United States who would be eligible to enter on investor visas and could make a big contribution to the economy, but when they mention, “by the way, FIF means…” people suddenly say, “no way”.

The tax system creates enormous challenges when Andrew Schmidt is trying to bring talent into New Zealand. Because the situation is so complex, only about half the people he speaks to understand it. Of five top-tier international executives he has targeted for recruitment, he has only succeeded in bringing one in, and FIF is one of the major constraints. Andrew is concerned that the people who are walking away from these roles despite having a deep interest in moving to New Zealand are very well-networked and likely sharing their understanding of these implications with others.

Ethan Graham has stopped ‘talking up’ New Zealand to others in his professional network who could make major economic contributions here. He doesn’t feel he can, in good conscience, expose these people to the uncertainty and risk created by the New Zealand tax rules.