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Title: **Cabinet Paper: ECO-25-SUB-0020: Changes to Foreign Investment Fund Rules**

Date: **5 March 2025**

Creator: **Offices of the Minister of Finance and the Minister of Revenue**

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Office of the Minister of Finance
Office of the Minister of Revenue
Chair, Cabinet Economic Policy Committee

CHANGES TO THE FOREIGN INVESTMENT FUND RULES

Proposal

- 1 This paper seeks the Cabinet's agreement to amend the foreign investment fund (FIF) rules to make New Zealand a more attractive destination for desirable migrants.
- 2 Primarily, the proposal adds a new method to the FIF regime that allows new migrants to be taxed on a realisation basis for illiquid FIF interests they acquired prior to their migration to New Zealand. Included in this proposal is for this new method to also be available for all FIF interests held by a person who remains subject to taxation on those interests in another country on a citizenship basis.
- 3 Should Cabinet agree to the proposals, a further programme of work on related tax policy issues will be pursued to further enhance New Zealand's appeal to talented and desirable migrants and also to ensure that other residents are not discouraged by the tax rules from staying in New Zealand.

Relation to Government priorities

- 4 This proposal supports the Government's focus on growing the economy by amending our tax system to remove a barrier to migration. It targets areas of the FIF rules that disincentivise highly skilled, well connected and wealthy migrants – particularly in the technology and start-up sector, from coming to and staying in New Zealand.

Executive summary

- 5 Inland Revenue officials were directed to release an issues paper to engage in public consultation on a proposal to reduce tax barriers to attracting and retaining desirable migrants in New Zealand. The proposals outlined in the issues paper focused on the challenges imposed by the FIF regime, as it was commonly said to be the most serious barrier, for instance by the New Zealand Institute of Economic Research in their paper published April 2024.
- 6 The current FIF rules that generally tax deemed or notional income were said to be unattractive to migrants not only due to their uniqueness, but also due to difficulties relating to double taxation and funding the FIF tax liability.

- 7 We therefore propose the introduction of a new calculation method in the FIF regime - the revenue account method. This method will be available for use by new migrants for their pre-migration illiquid FIF investments. It will allow these investments to be taxed on a realisation basis. New Zealand residents subject to citizenship-based taxation in another jurisdiction and therefore exposed to risks of double taxation on their FIF interests, will be able to apply the method to all their FIF interests.
- 8 If Cabinet agrees to these changes, we propose for the fiscal cost of \$1.933 million (at maximum) over the forecast period to be funded via the scorecard and legislated via the Taxation (Annual Rates for 2025-26) Bill. Using this Bill as the legislative vehicle will provide officials with the opportunity to further consult with stakeholders to ensure the technical design and parameters are fit for purpose.
- 9 Throughout public consultation, related tax policy issues within and outside of the FIF regime were raised as barriers to migration to and staying in New Zealand. Further policy work will therefore be undertaken to consider certain other changes to complement the proposed reform.

Background

- 10 The FIF regime was introduced in the late 1980s to remove the tax-driven incentive for New Zealand residents to invest in foreign enterprises (where in the absence of the FIF regime, generally only dividends would be subject to New Zealand tax) over domestic ones. Since 2007, the rules achieve this by taxing residents at their marginal rate on either 5% of the value of the FIF interest at the beginning of the year or (for natural persons) their actual gains if the total return from their FIF portfolio is lower than 5%. Net losses are generally not deductible.
- 11 These settings are now said to be discouraging desirable migrants from coming to and staying in New Zealand, for instance by the New Zealand Institute of Economic Research in their paper published April 2024, 'The place where talent does not want to live'.
- 12 In December last year, Inland Revenue released an issues paper for public consultation on the effects of the FIF rules on immigration and three possible solutions. Public consultation on the proposals opened on 6 December 2024 and closed on 27 January 2025. Ninety-eight written submissions were received.
- 13 The submissions generally agreed that the FIF rules significantly disincentivise migration. Many taxpayers preferred being taxed on a realisation basis rather than on a notional basis, especially objecting against being taxed on investments on which they ultimately suffer an economic loss. Furthermore, many inbound migrants are more accustomed to a capital gains tax as this is the approach in their home jurisdiction.
- 14 From a practical standpoint, taxing notional income can give rise to liquidity issues, if those investments do not pay enough dividends to cover the tax liability and are hard to sell. For such FIF interests, taxpayers have to fund their FIF tax liability with other assets or borrowing. Taxpayers may also face double taxation, with the most issues arising for United States (US) citizens.

- 15 After considering the submissions, we are proposing some FIF reforms to improve New Zealand's appeal to desirable migrants.

Revenue account method

General proposal

- 16 We propose adding a new method to the FIF regime (the revenue account method). The revenue account method would allow eligible taxpayers to elect for certain FIF interests to be taxed on a realisation basis. This means that only dividends received from those FIF interests and any gains on disposal of those interests are taxable.
- 17 We propose for the revenue account method to only apply to illiquid FIF interests that were acquired before a person comes to New Zealand. FIF interests acquired after the person comes to New Zealand would not be eligible to be taxed under the revenue account method. However, we propose an exception be made for follow-on investments made in illiquid FIF interests that were acquired pre-migration and for illiquid FIF interests acquired post-migration as a result of pre-migration employment. The first exception accounts for circumstances under which a migrant New Zealand tax resident is required to continue investing in illiquid FIF interests due to an agreement made prior to coming to New Zealand.
- 18 The method does not generally apply to investments in listed companies, as these are easy to value and easy to sell if the person either needs cash to pay the FIF tax, or does not want to be subject to tax on notional income (the same choice other residents face).
- 19 There is an important exception to the pre-migration and unlisted requirements. We propose that residents who are subject to tax on their FIF investments on a citizenship basis in another jurisdiction be allowed to apply the revenue account method on all FIF interests. This proposal would primarily apply to migrants from the United States (US), who generally remain subject to US capital gains tax on all assets sold, regardless of being tax resident elsewhere. As they are subject to taxation based on their citizenship rather than where they actually reside, they face the risk of double taxation on all FIF interests if the New Zealand tax they pay is not creditable against the US tax. Under the current FIF rules, there is some uncertainty about this. Moving to the revenue account method should resolve this issue.
- 20 As the proposed reform is targeted towards attracting and retaining migrants, we propose that the revenue account method be available only to individuals and certain trusts.

Eligibility and application date

- 21 For a person to be eligible for the revenue account method, we propose that the person must have been a non-resident for a period of less than ten years, with the exact length to be agreed between the Minister of Finance and the Minister of Revenue. For returning New Zealanders, they would not be able to apply the revenue account method on illiquid FIF interests acquired while they were still a New Zealand resident or while they were away from New Zealand for a period of less than that. We propose for the Minister of Finance and the Minister of Revenue to be delegated authority to approve the exact period of absence required.

- 22 We propose that a person who meets the absence test and becomes fully tax resident on or after 1 April 2024 is able to use the revenue account method. In this context, “fully tax resident” means someone who is a New Zealand tax resident and is not a transitional resident. Transitional residence is available for the first four years of a migrant’s residence here and generally exempts them from New Zealand taxation on foreign sourced income that is not from personal services. This proposal would mean that an existing migrant New Zealand resident whose transitional resident status expired before this date would be treated the same way as a person who has always been in New Zealand and would not be eligible to use the revenue account method.
- 23 A family trust may use the revenue account method in relation to an eligible investment if the principal settlor is a person who meets the proposed eligibility criteria for individuals.

Election

- 24 We propose that the revenue account method be elective so taxpayers retain the flexibility to choose the best FIF method for their particular portfolio of investments. Eligible taxpayers would have to make an election in the first year they become subject to the FIF regime.

Rate

- 25 The broad consensus from public consultation on Inland Revenue’s issues paper is that taxing gains on disposal of FIF interests at the taxpayer’s marginal tax rate would not achieve the goal of the reform, particularly at the higher rates. This is because capital gains are generally taxed at a discounted rate internationally. We consider that a lower effective tax rate is warranted to achieve the policy objective of reducing tax barriers for highly desirable non-residents to move to New Zealand.
- 26 Accordingly, we propose that any gain on disposal of FIF interests subject to the revenue account method be discounted by 30% before being taxed at the taxpayer’s marginal income tax rate. For a person with a marginal tax rate of 39%, this would reduce the effective tax rate to 27.3%. This is a similar rate to the maximum rate applying to income earned through a portfolio investment entity, including FIF income.

Exit tax on migration

- 27 We propose that migration from New Zealand should, at least in some circumstances result in a deemed disposal of FIF interests taxed under the revenue account method, so that unrealised gain or loss up to that point would be subject to tax. This is an integrity measure that is common in jurisdictions which have a capital gains tax regime. The terms of an exit tax require further work, and we ask that determining these terms be delegated to the Ministers of Finance and Revenue.

Losses

- 28 We propose that net losses arising under the revenue account method should be available to be offset against gains arising under the revenue account method only.
- 29 We also propose that taxpayers be able to carry these losses forward to offset gains in future years.

Financial implications

- 33
- The fiscal cost of the introduction of the revenue account method for migrants’ pre-migration illiquid FIF interests will depend on the number of years required for returning New Zealanders to be personally absent from New Zealand to qualify as a migrant.
- 34
- Should the Minister of Finance and Minister of Revenue decide to require 5 years of absence, the proposal would have a fiscal cost of \$1.381 million over the forecast period.

	\$ million increase / (decrease)				
Vote Revenue Minister of Revenue	2024/25	2025/26	2026/27	2027/28	2028/29 & Outyears
Tax Revenue: Other persons					
Turning off FIF	0.000	0.000	(0.100)	(0.750)	(2.100)
Replacement tax treatment	0.000	0.000	0.053	0.399	1.117
Total Revenue	0.000	0.000	(0.047)	(0.351)	(0.983)

Total Operating	0.000	0.000	0.047	0.351	0.983
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- 35 Should the Minister of Finance and Minister of Revenue decide to require 3 years of absence, the proposal would have a fiscal cost of \$1.933 million over the forecast period.

	\$ million increase / (decrease)				
Vote Revenue Minister of Revenue	2024/25	2025/26	2026/27	2027/28	2028/29 & Outyears
Tax Revenue: Other persons					
Turning off FIF	0.000	0.000	(0.140)	(1.050)	(2.940)
Replacement tax treatment	0.000	0.000	0.074	0.559	1.564
Total Revenue	0.000	0.000	(0.066)	(0.491)	(1.376)
Total Operating	0.000	0.000	0.066	0.491	1.376

- 36 The fiscal costs will be accounted for on the Tax Policy Scorecard.
- 37 The fiscal costs do not include any increase in tax revenue due to migrants who choose to come here as a result of the change. Officials have no sound basis to estimate the scale of any behavioural change arising out of the FIF changes, so this has not been included in the fiscal estimate.
- 38 The departmental costs for administering and implementing the revenue account method as proposed total \$0.780 million over the forecast period. Inland Revenue will self-fund this initiative.

	\$ million increase / (decrease)				
Inland Revenue	2024/25	2025/26	2026/27	2027/28	2028/29 & Outyears
One-off implementation	-	0.200	-	-	-
Ongoing administration	-	0.010	0.070	0.150	0.150
Total operating (inc/dec)	-	0.210	0.070	0.150	0.150
Capital injection	-	0.200	-	-	-
Total capital impact (inc/dec)	-	0.200	-	-	-
Total	-	0.410	0.070	0.150	0.150

Legislative implications

- 39 Implementing these proposals require changes to the Income Tax Act 2007 and the Tax Administration Act 1994.
- 40 If approved, we propose including the legislative changes resulting from these recommendations in the Taxation (Annual Rates for 2025-26) Bill, anticipated for introduction in August 2025.

Impact analysis

Regulatory impact assessment

- 41 The Ministry for Regulation has determined that this proposal is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it has no or only minor economic, social, or environmental impacts.

Climate implications of policy assessment

- 42 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this policy proposal, as the threshold for significance is not met.

Population implications

- 43 The proposals are not expected to have any undue implications for specific demographics in New Zealand.

Human rights

- 44 There are not human rights implications associated with the proposals.

Consultation

- 45 The Treasury was consulted on this paper.
- 46 An officials' consultation paper was published on 6 December 2024 for public consultation and closed 27 January 2025. Ninety-eight written submissions were received and analysed to inform the proposal.

Communications

- 47 The proposal will be announced at the New Zealand Infrastructure Investment Summit, to be held 13 – 14 March 2025. Further commentary on the proposal will be released with the Taxation (Annual Rates for 2025-26) Bill's commentary. Inland Revenue will include details of the new legislative provisions giving effect to the proposals in a *Tax Information Bulletin* after the Bill is enacted.

Proactive release

- 48 We propose for this Cabinet paper, associated minutes and key advice papers to be released as part of the Budget 2025 proactive release.

Recommendations

We recommend that the Committee:

- 1 **agree** to add a new method to the foreign investment fund regime which allows for specified foreign investment fund interests to be taxed on a realisation basis (the revenue account method), which means that only dividends received and gains on sale are taxed.

- 2 **agree** that a person would be eligible to apply the revenue account method on eligible foreign investment fund interests only if they have been personally absent from New Zealand for a period to be agreed between the Minister of Finance and the Minister of Revenue.
- 3 **agree** that the proposal would be available to people that became fully tax resident in New Zealand on or after 1 April 2024, subject to them meeting the eligibility criteria referred to in recommendation 2.
- 4 **agree** that a family trust would be eligible to apply the revenue account method on eligible foreign investment fund interests if the principal settlor of that trust is eligible pursuant to the criteria set out in recommendations 2 and 3.
- 5 **agree** that an eligible person who is subject to taxation by another jurisdiction on a citizenship basis should be allowed to apply the revenue account method on all foreign investment fund interests, including interests that are liquid and interests acquired after coming to New Zealand, subject to them meeting the criteria set out in recommendations 2 and 3.
- 6 **agree** that with the exception of interests referred to in recommendation 5, the revenue account method would only apply to:
 - 6.1 foreign investment fund interests that are illiquid and acquired while the person was non-resident.
 - 6.2 certain follow-on investments into foreign investment fund interests made after a person has become New Zealand resident but in relation to investments acquired before coming to New Zealand.
 - 6.3 Foreign investment fund interests acquired as a result of overseas employment.
- 7 **agree** that gains or losses on disposal of any foreign investment fund interests would be subject to a 30% discount before being taxed at the taxpayer's marginal income tax rate.
- 8 **agree** that the revenue account method would apply from 1 April 2025 onwards.
- 9 **agree** that losses on disposal of any foreign investment fund interests to which the revenue account method is applied are only available to be offset against any gains on disposal of any foreign investment fund interests to which the revenue account method is also applied with any excess losses carried forward into future years.
- 10 **agree** that the reform include some form of exit tax which would apply to shareholders who cease to be New Zealand resident while holding shares subject to the revenue account method.
- 11 **authorise** the Minister of Finance and Minister of Revenue to jointly approve minor, administrative and technical policy decisions that give effect to the changes, including the exact period of absence required for eligibility and the detailed design of the exit tax.

12 ^[33]

Financial implications

13 **note** the fiscal costs of the proposal will depend on the Ministers of Finance and Revenue's decision on the absence test for returning New Zealand residents, though it will have a maximum fiscal impact of \$1.933 million on the operating balance and/or net core Crown debt over the forecast period:

	\$ million increase / (decrease)				
Vote Revenue Minister of Revenue	2024/25	2025/26	2026/27	2027/28	2028/29 & Outyears
Tax Revenue: Other persons					
Turning off FIF	0.000	0.000	(0.140)	(1.050)	(2.940)
Replacement tax treatment	0.000	0.000	0.074	0.559	1.564
Total Revenue	0.000	0.000	(0.066)	(0.491)	(1.376)
Total Operating	0.000	0.000	0.066	0.491	1.376

14 **note** the tax revenue fiscal impacts of this proposal would be accounted for on the Tax Policy Scorecard.

15 **note** that Inland Revenue will self-fund the departmental costs to implement and administer these changes estimated at \$0.780 million:

	\$ million increase / (decrease)				
Vote Revenue Minister of Revenue	2024/25	2025/26	2026/27	2027/28	2028/29 & Outyears
Multi-Category Expenses and Capital Expenditure: Services for Customers MCA					
Services to Ministers and to assist and inform customers to get it right from the start	-	0.010	-	-	-
Services to process obligations and entitlements	-	0.200	0.070	0.150	0.150
Total	-	0.210	0.070	0.150	0.150
Inland Revenue Department – Capital Expenditure PLA	-	0.200	-	-	-
Total Operating	-	0.210	0.070	0.150	0.150
Total Capital	-	0.200	-	-	-

Authorised for lodgement

Hon Nicola Willis

Minister of Finance

Hon Simon Watts

Minister of Revenue