

QUESTIONS WE'VE BEEN ASKED > RWT and NRWT

Whether “negative interest” payments are subject to withholding taxes

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This Question We've Been Asked (QWBA) explains the application of the resident withholding tax (RWT) and non-resident withholding tax (NRWT) rules to situations where negative interest is charged on an advance of money or a loan.

The Commissioner has been asked this question by banks and financial institutions because they wish to have appropriate processes in place should the RWT and NRWT rules apply to negative interest payments and they are required to withhold tax.

Key provisions

Income Tax Act 2007 – subparts RE and RF, s YA 1 definitions of “interest” and “money lent”.

Legislative references are to the Income Tax Act 2007, unless otherwise specified.

Question

Is a “negative interest” payment subject to resident withholding tax (RWT) or non-resident withholding tax (NRWT)?

Answer

No. The payment will not be subject to withholding taxes. For the RWT and NRWT rules to apply the payment must be made to a person by another person for money lent. Negative interest cannot truly be said to be paid *for* money lent. If it was paid “for” money lent then it would be in return for the money lent. However, negative

interest is paid to the person receiving the money and it is not a return to a lender from a loan. This conclusion is consistent with the legislative history and case law on the meaning of “interest”.

Key terms

RWT and **NRWT** are taxes that are deducted from investment income before the investor receives it. In the case of interest, a bank or financial institution will usually deduct RWT or NRWT at the applicable rate before paying the interest to the investor.

Negative interest payment means a payment made as a term of a financial transaction (arrangement) where money is advanced at a negative rate of interest. A negative interest payment is made by the person advancing the money to the person receiving the money. It effectively reverses the usual position for interest where the borrower pays interest to the lender.

Background

1. The official cash rate is an interest rate the Reserve Bank of New Zealand sets for use between banks (in the wholesale market). Other interest rates in the retail market – between banks and customers – are priced with reference to the official cash rate.
2. New Zealand has never had negative interest rates and, while unusual, such practice is being considered widely overseas. Banks and financial institutions are putting in place processes for the possibility of a negative official cash rate, and the Commissioner has been asked whether withholding taxes will apply to negative interest payments. This issue is less relevant for other taxpayers as they do not usually need to consider whether to withhold RWT or NRWT.
3. The scope of this question is concerned with only whether it is necessary to withhold RWT and NRWT and is not intended to address the tax consequences of negative interest generally.

Explanation

RWT and NRWT rules

4. Normally, interest payments would be subject to withholding under the RWT and NRWT rules. The question is whether negative interest payments come within the RWT or NRWT rules by virtue of being:
 - “resident passive income” as defined in s RE 2; or

- “non-resident passive income” as defined in s RF 2.
5. This turns on whether the negative interest payment is “interest” for “money lent” (both as defined in s YA 1).

“Interest” for “money lent”

6. The s YA 1 definitions of “interest” and “money lent” are wide and relevantly state:

interest,—

- (a) for a person’s income,—
- (i) means a payment made to the person by another person **for** money lent **to** any person, whether or not the payment is periodical and however it is described or calculated; and
 - (ii) does not include a redemption payment; and
 - (iii) does not include a repayment of money lent:

...

money lent means—

- (a) an amount of money that a person lends in some way, including by depositing it in an account, whether or not the lending is secured or evidenced in writing: [Emphasis added]

7. The definition of “money lent” states that an amount will be money lent, if it is an amount of money that a person “lends” in some way. Depending on the particulars of the transaction, it is arguable that the money advanced in a negative interest transaction is money lent. Similarly, there is an argument that negative interest would be the **payment** required under the definition of interest. However, the Commissioner’s view is that a negative interest is not truly a payment made to the borrower “for” money lent “to” the borrower.

Meaning of “for”

8. If “for” in this context requires or implies the giving of interest in exchange – and countervailing with – the money lent, then negative interest is not paid “for” the relevant money lent. Put simply, the negative interest payment will not be in exchange for the money lent because both payments flow in the same direction; that is, one party pays both the money and negative interest to the recipient of the funds.
9. “For” is not defined in the Act. Dictionary definitions indicate that the word “for” can have a variety of meanings depending on the context in which it is found. Definitions range from “in exchange for”, which suggests a direct connection, to “having as a purpose or function” and “with regard to”, which permit a wider connection. The case law on the meaning of “for” recognises that it is a “rubbery” word that has a variety of meanings depending on the context (*Wilson & Horton v CIR* (1995) 17 NZTC 12,325 (CA)).

10. On the one hand, it could be argued negative interest is paid “with regard” to the money lent. There is a nexus in the sense that, absent money lent in a particular arrangement between two parties, negative interest would not be paid under that arrangement.
11. However, the Commissioner considers that the better view is that, in this context, “for” implies the giving of interest in exchange – and countervailing with – the money lent. The word “to” – in the context of the phrase “payment ... for money lent to” – arguably provides some interpretive support for this interpretation of “for”. The “for ... to” language provides a suggestion that the most appropriate meaning of “for” in this context is in a countervailing, exchange-type manner. Other factors support this interpretation of “for”:
 - The previous definition of “interest” in s OB 1 of Income Tax Act 1994 is narrower than the current definition and appears to envisage interest being paid to the lender.
 - The immediate legislative context appears to support the proposition that the legislation is concerned with interest paid to the lender and not with payments made to the borrower. Paragraphs (b) and (bb) of the current s YA 1 definition of “interest” both appear to equate the person making payment as being the person who was lent the money.
 - In terms of purpose, the definitions of “interest” and “money lent” were introduced to the Income Tax Act 1976 by the Income Tax Amendment Act 1983 with the apparent intent of taxing returns to the lender.¹
12. Based on this interpretation of “for”, a negative interest payment will not be “for” money lent. The negative interest flows in the same direction as the money lent, so it is not given in exchange for the money lent (rather, the payment appears to be made for receiving, accepting or holding the money). “Interest” should, in this context, be the price or compensation for providing money lent – on a time value of money basis or otherwise – and that does not appear to be the case for negative interest.
13. In summary, the Commissioner considers that negative interest does not meet the s YA 1 definition of interest because it is not a payment for money lent. In simple terms, it will be “interest” where the borrower pays the lender **for** the money lent. In this case, the lender is paying the borrower for the receiving, acceptance or holding of the money.

¹ See the Rt Hon RD Muldoon’s Budget speech introducing the new definition of “interest” in *Parliamentary Papers B.6, Financial Statement* (House of Representatives, Wellington, 28 July 1983); p 26. This passage was also discussed in *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 (CA).

RWT and NRWT will not apply

14. Negative interest will not be resident passive income or non-resident passive income and subject to RWT and NRWT. Negative interest payments will still be subject to income tax but there is no withholding requirement on such payments. A further consequence of this conclusion is that the reporting requirements on banks and financial institutions for interest do not apply to negative interest payments.

Examples

EXAMPLE 1 - RWT treatment where a financial institution is party to a negative interest transaction

XYZ Regional Finance Ltd (XYZ) is a small sized financial institution based in New Zealand. It is involved in wholesale banking (that is, lending between banks and financial institutions) and retail banking (that is, financial services provided to customers and individuals).

As part of its banking requirements XYZ is required to deposit surplus funds overnight with one of the main registered banks. In normal circumstances XYZ will receive interest (at positive interest rates) less any applicable RWT or NRWT. XYZ wants to know whether there will be withholding taxes if the Reserve Bank introduces a negative official cash rate that flows into the wholesale lending market. In this scenario, XYZ expects it would be charged interest from the large national banks at -0.25% for its overnight deposits. This would mean XYZ depositing the money and the bank charging XYZ negative interest in return for XYZ depositing the money.

Notwithstanding that the registered bank may have a certificate of exemption from RWT, withholding would not apply because the negative interest is not resident passive income (so is not subject to RWT) because it cannot be said to be interest **for** money lent. XYZ advances the money lent to the registered bank, and the negative interest is not provided "for" the money lent as it is not provided from the registered bank (the borrower) to XYZ (the lender).

The negative interest payment received by the registered bank will still be subject to income tax but XYZ has no withholding requirement because the RWT rules will not apply.

EXAMPLE 2 - RWT treatment for a loan to a company

The nature of Company A's business is that, from time to time, it needs to borrow funds to meet its immediate day-to-day cashflow requirements. It has a loan facility

with Company B for this purpose (Company B has an exemption certificate but Company A does not). The longstanding agreement between the companies is that Company A pays a rate of interest that is 0.25% higher than the Official Cash Rate. In the event of a negative OCR there is a possibility that there will be a negative interest rate and the companies want to know whether withholding will apply.

There is no withholding. Negative interest is not an amount paid in return for the money lent – it is Company B (the lender), rather than Company A (the borrower), that is making the payment. Consequently, negative interest is not resident passive income and is not subject to withholding (although it will still be taxable).

References

Legislative references

Income Tax Act 1976

Income Tax Act 1994, s OB 1 (“interest”)

Income Tax Act 2007, subparts RE (s RE 2) and RF (s RF 2), s YA 1 (“interest”, “money lent”)

Income Tax Amendment Act 1983

Case references

Marac Life Assurance Ltd v CIR [1986] 1 NZLR 694 (CA).

Wilson & Horton v CIR (1995) 17 NZTC 12,325 (CA).

Other references

Concise Oxford Dictionary (12th ed, Oxford University Press, 2011).

Rt Hon RD Muldoon, Budget speech introducing the new definition of ‘interest’, *Parliamentary Papers B.6, Financial Statement* (House of Representatives, Wellington, 28 July 1983): p 26.

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