

2 October 2007

The Chairperson
Finance and Expenditure Select Committee
Parliament Buildings
WELLINGTON

Dear Sir

Submission on the Limited Partnerships Bill

This submission is from Grant Thornton New Zealand.

Grant Thornton New Zealand is a national association of independently owned and operated firms. This submission is made on behalf of those firms.

We do not wish to appear before the committee.

Summary

Grant Thornton acts as adviser to a number of clients involved in the venture capital sector to whom the provisions of this Bill are targeted. We fully support the fundamental proposals in the Bill which provide a legislative framework for limited partnerships to operate in New Zealand, as they do in most other countries which we compete with in the venture capital market, and see it as a positive step for New Zealand as a whole.

However we consider that these positives will be negated by the provisions of the proposed sections HD 11 and HD 12 included in clause 116 of the Bill and therefore make the following submission.

Submission

That the proposed sections HD 11 and HD 12 which limit limited partners deduction for any proportion of a limited partnership loss to the so called "economic loss" of the limited partner be removed.

Comment

The effect of the proposed sections HD 11 and HD 12 is that limited partnerships are at a disadvantage to other similar types of investment vehicles such as Loss Attributing Qualifying Companies ("LAQCs"). Further it seeks to introduce a concept of "economic loss" into the taxation system without a fundamental analysis of whether this is the most appropriate principle to be used in the taxation system. Clearly taxation by "economic equivalence" has been considered and rejected a number of times over a number of decades and appears nowhere else in the current Income Tax Act.

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For “base maintenance” reasons, officials may have decided that there should be restrictions in order to avoid historical examples of tax avoidance schemes that have been prevalent in such venture capital ventures such as films. However such schemes are historic and the particular aspects of the schemes that Government’s have judged to be unacceptable have been dealt with by introducing new legislation e.g. non-recourse funding. Alternatively Inland Revenue has been known to invoke the anti-avoidance provisions of the Income Tax Act.

One of the impacts of the proposed limitations to economic loss that we envisage is that New Zealand based limited partners may not be able to obtain a deduction for their share of any interest paid by the limited partnership on any borrowing made by the partnership where the partnership is in a loss situation. This is due to the formula in the proposed section HD 11 which limits the partners deduction to the contributions by the limited partner and the “guaranteed amounts”, which are defined as the limited partnership’s share of the limited partnership’s debt “to the extent that the partner has given a guarantee or indemnity to that debt”.

A limited partnership is a separate legal entity but its attractiveness was because of the ability to still be treated as if it was a partnership for tax purposes. This benefit or attractiveness is effectively wiped, for NZ tax residents at least, by the provisions of section HD 11 and HD 12. To offer the benefit of a limited partnership regime and then effectively squash any benefits to a number of potential investors is akin to winning a million dollars in a lottery and then being told that it is in Zimbabwean currency!

As is common with most businesses, limited partnerships are likely to want to have a mixture of debt and equity for use in the business. Therefore we do not believe that limited partnerships should be penalised for having the ability to obtain finance to fund their operations without recourse having to be made to guarantees or indemnities provided by the limited partners.

We consider that New Zealand investors will be unwilling to enter a limited partnership with these restrictions imposed upon them. This will have a flow on to overseas venture capitalists who likewise will be unwilling to commit the partnership as they are in effect looking to join a joint venture and not to be a 100% owner. Overseas investors are seeking to enter into a joint venture with New Zealand investors who will also be limited partners. Therefore unless overseas investors are willing to take up 100% of the funding, in which case a partnership is not required, the New Zealand investors would oppose the use of a limited partnership and instead opt for a joint venture made up of Loss Attributing Qualifying Companies.

Further the reality is that the industries that are likely to use limited partnerships are industries that because of their speculative nature have special tax regimes which while not being classed as having incentives often give deductions earlier than what is generally the case. Therefore in the early stages of the ventures it is highly likely that losses will be made even though overall, when all the years the venture will operate is taken into account, a profit will be made. There would appear to be no valid reason why limited partners should not be able to account for tax in the same manner that shareholders in a Loss Attributing Qualifying Company do.

Principle Policy

It appears that sitting behind the proposed sections HD 11 and HD 12 is a principle/policy that New Zealand (or at least Treasury who of course have New Zealand’s best interests at heart) wants overseas investors to invest in these venture capital projects and does not want New Zealand investors to do so. We do not have the economic expertise to determine whether from an economic standpoint this is the correct approach. However we do consider, in order to make the policy making process transparent, that this should be acknowledged as the primary reason behind the limiting of the losses for limited partners.

Should you wish to discuss any of the issues please contact me.

Kind Regards

Grant Thornton



Greg Thompson
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