Regulatory Impact Statement: Changes to the thin capitalisation rules for foreign-owned New Zealand banking groups

Decision sought	Final Cabinet decisions
Agency responsible	Inland Revenue
Proposing Ministers	Finance, Revenue
Date finalised	18 August 2026

Description of the Minister's regulatory proposal

The bank thin capitalisation rules are intended to set minimum capital requirements for foreign-owned New Zealand banking groups for tax purposes at a commercial level. This acts as a base protection measure by restricting the amount of debt from overseas parts of the group that can reduce tax paid in New Zealand. The rules require updating to reflect current commercial settings, as prudential settings have changed over time. The general thin capitalisation rules for non-bank foreign-owned entities are out of scope of this proposal.

The proposal is to increase the minimum capital requirements for tax purposes to align more closely with prudential capital requirements that were announced by the Reserve Bank of New Zealand in December 2025. Different requirements will apply for different sized banks in line with the Reserve Bank's approach to prudential regulation. The changes will provide for temporary variations to these tax requirements when the Reserve Bank makes changes to the prudential capital requirements in times of systemic stress.

Summary: Problem definition and options

What is the policy problem?

Prudential capital requirements have increased in New Zealand and globally to a point where they are now much higher than what New Zealand's thin capitalisation rules require for tax purposes. As a result, the thin capitalisation rules do not require New Zealand banking groups to hold a commercial level of capital for tax purposes, providing opportunities for banks to use debt from overseas parts of a group to reduce tax payable in New Zealand.

The thin capitalisation rules operate by limiting the amount of deductible interest that can be recognised for tax purposes in New Zealand, to prevent debt being used to shift profits overseas. For banks, the thin capitalisation rules are applied at the level of the New Zealand banking group, which includes holding companies and branches. However, holding companies and branches are ignored for New Zealand prudential regulation purposes. The narrower scope of the prudential capital requirements means that New Zealand banking groups can lower their capital ratio for tax purposes, without breaching the prudential capital requirements, by taking on extra debt at the holding company level or in a branch, which increases interest deductions in New Zealand. This creates headroom for banks to increase the levels of debt in their New Zealand groups, which increases tax deductions. This is because they can hold higher levels of debt for tax purposes than they are permitted to under prudential capital settings.

What is the policy objective?

The objective is to ensure that foreign-owned New Zealand banking groups are required to hold a commercial level of capital for tax purposes. This will help to protect the tax base.

What policy options have been considered, including any alternatives to regulation?

The scope of options is limited by the existing thin capitalisation rules which already effectively and efficiently set minimum capital requirements for banking groups for tax purposes, and by the policy intention of these rules, which is to require a commercial level of capital. The problem is that the threshold in the rules is not currently set at a commercial level due to changes in prudential capital requirements. Changing the threshold will require legislative change. No non-regulatory options are available.

Ministers' preferred option was option 2. The following policy options were considered as part of this project:

Option 1 – Retain the status quo: As New Zealand's current tax thin capitalisation rules requirements are much lower than prudential capital requirements, additional debt can be added to New Zealand banking groups via holding companies which increases a group's tax deductions. And where there is a branch in a group, more debt can be allocated to the branch on a proportional basis, which increases tax deductions. Retaining the status quo means that this problem will not be addressed.

Option 2 – Raise the thin capitalisation threshold to align closely with prudential capital requirements set by the Reserve Bank of New Zealand: This option would increase banking groups' capital requirements for tax purposes to line up closely with Tier 1 capital requirements (including the prudential capital buffer[1]) which were announced by the Reserve Bank of New Zealand in December 2025 and come into effect in December 2028. Aligning with the requirements announced in December 2025 would be the optimal way to ensure that banking groups are treated as holding a commercial level of capital for tax purposes, limiting their ability to use debt from overseas parts of the group to reduce their New Zealand tax liability. Different capital requirements would apply for different sized banking groups in line with the Reserve Bank's approach to prudential regulation – that is, 12%[2] of risk-weighted assets for groups that include a domestic systemically important bank, and 11%[3] for other groups. The changes would also provide for temporary variations to these tax requirements when the Reserve Bank makes changes to the prudential capital requirements in times of systemic stress.

[1] This is a cushion of capital that banks must hold above their minimum Tier 1 capital requirements to absorb unexpected losses.

[2] Aligning with the Reserve Bank's requirement for group 1 deposit takers (systemically important banks that hold $100 billion or more of assets).

[3] Aligning with the Reserve Bank's requirement for group 2 deposit takers.

Other options would involve diverging from the prevailing commercial settings reflected in Reserve Bank's prudential capital requirements, and so would not meet the objective of requiring a commercial level of capital. Accordingly they have not been considered further.
What external consultation has been undertaken? We have undertaken two rounds of targeted consultation with affected banking groups and relevant professional bodies. The first round ran from 9 September to 10 October 2025. In the initial consultation we considered capital levels in branches, but feedback highlighted the need to preserve the equal treatment of branches versus entities for tax purposes, and to use the existing thin capitalisation framework to address any policy problems in this area. We then refined our proposals to take this feedback into account and went back to stakeholders for a second round of consultation from 13 January to 17 February 2026. Stakeholders had mixed views on both the policy problem and the refined proposals. Most questioned the need for change and raised concerns about fairness if different thresholds are set for different sized banking groups and potential interference with prudential regulation if thresholds are aligned with Reserve Bank requirements. These stakeholders also said that if changes are made, the timing should coincide with the requirements announced by the Reserve Bank in December 2025, which come into effect in December 2028, to give groups time to adjust their capital levels. Some supported the proposal to align with prudential capital requirements and suggested this would be sensible tax policy. They said the tax changes could be implemented ahead of the Reserve Bank's changes because they should have limited impact, since the Reserve Bank's changes which come into effect in December 2028 are broadly in line with current prudential capital requirements. We also consulted with the Reserve Bank on the proposals from a market impacts perspective. They did not have concerns about market impacts from implementing changes to the tax rules before the changes to the prudential capital requirements apply. They also did not have concerns about market impacts from aligning with prudential capital requirements or setting different requirements for banking groups based on size in line with their approach.
Is the preferred option in the Cabinet paper the same as preferred option in the RIS? Ministers' preferred option in the Cabinet paper (option 2) is the same as officials' preferred option in the RIS.

Summary: Minister's preferred option in the Cabinet paper

Costs
Description of costs and where they fall The proposed increase in the thin capitalisation rules requirements would increase taxes in New Zealand for regulated banking groups by approximately $45m over the forecast period and approximately $15m per year for outyears. We expect that in most cases, the increased tax costs in New Zealand from increasing capital requirements for tax purposes would be substantially offset by reduced tax costs in overseas parts of these groups, due to a reduction in interest income from the New Zealand part of these groups. A potential risk is

that some affected groups may seek to pass on increased tax costs to customers. However, this risk is expected to be limited, as affected groups would need to remain competitive with groups that are not affected. Any passthrough, if it occurred, would likely be partial and small.

In this regard about half of the groups already hold sufficient capital to satisfy the proposed requirements, and almost all the other groups are not significantly below them, which means that raising the thin capitalisation rules requirements would generally have a limited impact on a group-by-group basis.

There may be minor transitional costs for some banks in restructuring their balance sheets (by replacing debt funding with equity funding) to meet the new requirements.

Ongoing compliance costs would be minimal, as banking groups already have systems in place for monitoring their tax equity position under the current rules.

An increase in the minimum capital requirements for tax purposes may in theory reduce incentives for banking groups to invest in New Zealand. However, we believe this particular change would not materially influence these incentives or restrict market competition given its limited impact on a group by group basis.

Benefits

Description of benefits and where they fall

The proposed increase in the thin capitalisation rules requirements would raise taxes for New Zealand by approximately $45m over the forecast period and approximately $15m per year for outyears. The distributional impacts are discussed in the section above. The proposed change would also protect approximately $240m per year of tax from being eroded by more debt being loaded into banking groups in the future.

We consider that aligning the thin capitalisation threshold with the prudential capital buffer requirement would generally support prudential regulation rather than undermine it because it would encourage banks to maintain the buffer or to reinstate it as quickly as possible.

Different prudential capital requirements apply for different size deposit takers. For example, group 1 deposit takers (also referred to as domestic systemically important banks), which hold assets of $100 billion or more, must hold capital equal to 11% of their risk weighted assets. Group 2 deposit takers, which hold assets of $2 billion to $100 billion, must hold capital of 10%.

These different prudential capital requirements for different size deposit takers may enhance competition. This is because the lower prudential capital requirements for group 2 deposit takers allows for a lower weighted average cost of capital so they can compete more effectively with large established market participants in group 1. We consider that setting different thin capitalisation requirements for group 1 and group 2 deposit takers, in line with prudential capital requirements, would support this pro-competition market setting.

Balance of benefits and costs

Does the RIS indicate that the benefits of the Minister's preferred option are likely to outweigh the costs?

The increased tax revenue, base protection benefits and support to market settings benefits outweigh the costs to banking groups (most of which should be offset by reduced tax costs overseas due to a reduction in interest income from the New Zealand part of these groups).

Implementation

How will the proposal be implemented, who will implement it, and what are the risks?

The changes would come into force on 1 April 2027. They would be included in the next Annual Rates Bill scheduled for introduction in the second half of 2026.

Guidance would be published by Inland Revenue explaining the changes.

Once implemented, Inland Revenue would monitor the effectiveness of the changes through our normal compliance activities and stakeholder feedback channels. Findings on compliance activity cannot be published due to taxpayer secrecy requirements.

Limitations and constraints on analysis

Our analysis has been informed by consultation with banking groups, thin capitalisation calculations that have been submitted to Inland Revenue by banking groups under the current rules, and results of the previous increase to the thin capitalisation rules requirements.

We had to make some assumptions to estimate the fiscal impact, such as banking groups' average cost of funds rate and the amount of their risk-weighted assets, however these assumptions were drawn from observable data, and we therefore believe they are robust.

I am satisfied that, given the available evidence, this RIS represents a reasonable view of the likely costs, benefits and impact of the preferred option.

Responsible Manager signature

Sam Rowe
Policy Lead
18 August 2026

Quality Assurance Statement

Reviewing Agency:	**QA rating:** Meets

Panel Comment:

A quality assurance panel comprising members from Inland Revenue has reviewed the Regulatory Impact Statement, *Changes to the Thin capitalisation settings for foreign-owned New Zealand banking groups*, prepared by Inland Revenue and dated 18 August 2026. The panel considers that the RIS meets the Quality Assurance criteria.

The RIS clearly explains the policy problem, the objectives of the reform, the options considered, and the reasons for the preferred option. It provides a balanced assessment of

the likely impacts, identifies the key assumptions and limitations underpinning the analysis, and appropriately reflects the views raised through consultation with affected banking groups and the Reserve Bank. The panel considers that the RIS provides Ministers with sufficient information of an appropriate quality to support informed decision-making.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. The Income Tax Act 2007 contains thin capitalisation rules for banks, which are intended to require a banking group's capital for tax purposes to be at a commercial level.

2. These rules were introduced in 2005 to address the problem of banks using cross-border financing from overseas parts of a group to reduce tax paid in New Zealand. The rules were designed to ensure that a foreign-owned banking group operating in New Zealand holds a minimum percentage of capital for tax purposes.

3. The thin capitalisation rules operate by limiting the amount of deductible interest that can be recognised for tax purposes in New Zealand. A thin capitalisation income adjustment effectively denies some interest deductions if the New Zealand banking group's capital ratio (that is, the ratio of its capital relative to its risk-weighted assets) is less than 6%.

4. The thin capitalisation rules apply on a group basis, in line with regular taxation principles. Entities and branches are included in a group for these purposes, providing for a neutral tax treatment of entities and branches[4]. Conversely, the Reserve Bank of New Zealand sets prudential capital requirements based on an entity approach because they regulate the banking sector on an entity-by-entity basis. They also only regulate banking entities, not other group entities such as holding companies. An entity approach was not considered appropriate in the tax context and this is a fundamental policy design setting of the banking thin capitalisation rules, because of the importance of maintaining neutrality between the treatment of entities and branches.

5. The current rate of 6% was set in 2012 to align with a planned increase in prudential capital requirements set by the Reserve Bank. The Reserve Bank's changes were partially in response to the global financial crisis to ensure banks held enough capital to withstand future economic shocks in the sector. The tax ratio could differ from the regulatory ratio, but aligning with the Reserve Bank's prudential capital requirements is an effective way of requiring a commercial level of capital, as these prudential settings provide a benchmark of the local commercial environment (this is because the Reserve Bank's prudential capital requirements apply to over 90% of the New Zealand banking industry[5]). All banks operating in New Zealand currently comply with their prudential capital requirements. Although the rate was aligned, it was never explicitly linked because this would tie the government's hands in responding to changes in the banking environment.

6. Since 2012, prudential capital requirements for banks have continued to increase locally and overseas to a point where they are now much higher than the thin capitalisation rules requirements for tax purposes. For example, in New Zealand, the Tier 1 capital requirement

[4] A branch refers to the part of a foreign entity doing business in New Zealand.

[5] The Reserve Bank requires foreign entities with branches in New Zealand to comply with prudential capital requirements in their country of residence instead of the Reserve Bank's prudential capital requirements, but branches only make up a small part of the New Zealand banking industry: https://www.rbnz.govt.nz/financial-stability/about-the-new-zealand-financial-system/financial-system-overview.

plus the prudential capital buffer[6] for domestic systemically important banks is currently 12.5% of risk-weighted assets, and for other banks is 10.5%.

7. From December 2028, the prudential capital requirements will change to 12% and 11% respectively. In comparison, the thin capitalisation ratio is still a single rate of 6%, meaning it is no longer set at a commercial level.

What is the policy problem or opportunity?

8. The thin capitalisation requirements for banks have not been updated since 2012, and they no longer reflect commercial settings. As a result, there are opportunities for foreign-owned banking groups to use debt from overseas parts of the group to increase interest deductions and reduce tax paid in New Zealand.

9. The thin capitalisation rules are applied at the level of the New Zealand group, which includes holding companies and branches. However, holding companies and branches are ignored for New Zealand prudential regulation purposes. The narrower scope of the prudential capital requirements means that the tax capital ratio of the New Zealand group can be much lower than the regulatory capital ratio of the bank. This can be an issue when the group takes on extra debt at the holding company level to place equity in the local operating bank entity, or at the branch level to fund lending, because it reduces tax paid in New Zealand.

10. Take, for example, a locally incorporated bank with a New Zealand holding company. The bank has $12 of Tier 1 Capital and $100 of risk-weighted assets. The bank's New Zealand holding company has $6 of equity and $6 of debt owing to overseas group members. The proceeds of the equity and debt were used to pay the bank $12 for shares issued to the holding company. As the holding company is ignored for prudential regulation purposes, the bank's Tier 1 capital ratio is 12% ($12 Tier 1 Capital/$100 risk-weighted assets). This would satisfy the prudential capital requirements announced in December 2025. At the same time, the group's total thin capitalisation ratio (factoring in the holding company) is only 6% ($6 of capital / $100 risk-weighted assets), which meets the current thin capitalisation threshold but is not a commercial level of capital.

11. The application of the banking thin capitalisation rules at the group level is a fundamental part of the policy settings. It provides for the neutral tax treatment of entities and branches. The problem is the result of the large difference between the thin capitalisation rate and the commercial settings established by the prudential capital requirements (rather than the differences in scope of the requirements). In addition, there are differences in prudential capital requirements for systemically important banks and other banks.

12. [redacted] As a result, raising the thin capitalisation rules requirements will generally have a limited impact on a group-by-group basis. While banks have generally not taken full advantage of the mismatch in prudential and tax requirements, there is a risk that their behaviour could change in the future if current thin capitalisation settings remain as they are. This could, for example, be the result of future changes in offshore tax rates.

[6] This is a cushion of capital that banks must hold above their minimum Tier 1 capital requirements to absorb unexpected losses.

13. Stakeholders had mixed views on the policy problem and the need to address it. See the section below titled ‘What consultation has been undertaken?’ for more information about stakeholders’ views.

What objectives are sought in relation to the policy problem?

14. The objective is to ensure that foreign-owned New Zealand banking groups are required to hold a commercial amount of capital for the purposes of the thin capitalisation rules. This will help to protect the tax base from cross-border related party debt or internal debt (from a head office to a branch) being used by banking groups to increase interest deductions and thereby reduce tax paid in New Zealand.

What consultation has been undertaken?

15. Inland Revenue undertook two rounds of targeted consultation with all the affected banks and relevant professional and industry bodies. The first round ran from 9 September to 10 October 2025. In the first round, a consultation letter was sent to 23 stakeholders, and written feedback was received from 9 of them. Following this, we refined our proposals and went back to stakeholders for a second round of consultation from 13 January to 17 February 2026. In the second round, a consultation letter was sent to 23 stakeholders, and written feedback was received from 12 of them.
16. In the first round, Inland Revenue consulted on narrower issues relating to capital levels in bank branches[7]. Stakeholders were broadly concerned about any targeted proposals addressing capital levels in branches because this would mean that branches and entities would have different capital rules for tax purposes, which could disrupt commercial decision making. Stakeholders who thought that changes could be made to address capital requirement problems, considered this should be done by raising the thin capitalisation threshold, as this would preserve the neutral tax treatment of entities and branches.
17. In the second round, Inland Revenue considered the broader issues relating to capital levels in banking groups and updated proposals on changes to the thin capitalisation rules for banking groups which would maintain the neutral tax treatment of entities and branches. Stakeholders had mixed views on both the refined policy problem and proposals. Ten stakeholders questioned the need for change, because generally banks are not taking full advantage of the mismatch between tax and prudential capital settings. They also raised level playing field concerns with setting different thin capitalisation thresholds for different sized banking groups in line with the prudential regulation approach. They were also concerned about potential interference with prudential regulation if thresholds are aligned with Reserve Bank requirements. These stakeholders said that if changes are made, the timing should coincide with the requirements announced by the Reserve Bank in December 2025 which come into effect in December 2028, to give groups time to adjust their capital levels.
18. Two stakeholders (one domestic systemically important bank and one smaller bank) supported the proposal to align with prudential capital requirements and suggested this would be sensible tax policy. They said the tax changes could be implemented before the Reserve Bank’s changes apply because they should have limited impact. This is because

[7] A branch refers to the part of a foreign entity doing business in New Zealand.

the Reserve Bank's changes which come into effect in December 2028 will only make minor changes to the current prudential capital requirements.

19. Inland Revenue also consulted with the Reserve Bank on the proposals from a market impacts perspective. The Reserve Bank did not have concerns about market impacts from implementing changes to the tax rules before the changes to the prudential capital requirements apply. They also did not have concerns about market impacts from aligning with prudential capital requirements or setting different requirements for banking groups, based on size, in line with their approach.

Section 2: Assessing options to address the policy problem

What criteria will be used to compare options to the status quo?

20. We have used the following criteria to assess the options against our objectives:
    - **Revenue integrity:** Does the option ensure that banking groups are required to hold a commercial level of capital, thus reducing opportunities for using cross-border related party financing or internal financing (from a head office to a branch) to increase tax deductions?
    - **Efficiency**: Does the option minimise distortions and costs to the economy?
    - **Compliance costs**: Does the option minimise costs for taxpayers?
    - **Coherence**: Does the option make sense within the entire tax system and broader regulatory regime for banks?

What scope will options be considered within?

21. The scope of options is limited by the existing thin capitalisation rules which already effectively set minimum capital requirements for banking groups for tax purposes, and by the policy intention of these rules, which is to require a commercial level of capital. Applying the rules on a group basis (instead of entity basis) provides a neutral tax treatment across different types of structures which is important from an efficiency perspective. This is another option-limiting factor. The problem is that the current threshold in the rules is too low because prudential capital requirements have increased significantly since the tax rules were last updated.

22. While the thin capitalisation threshold could differ from the Reserve Bank's prudential capital requirements, setting the threshold above or below the Reserve Bank's requirements is not considered optimal. This is because setting the tax threshold below the prudential capital requirements would leave the tax problem unaddressed. While setting the tax threshold above the prudential capital requirements could interfere with market stability. These are further option-limiting factors which point to alignment with the Reserve Bank's requirements. In this context, alignment also means the adoption of their tiered approach to capital requirements.

What options are being considered?

Option One – Retain the status quo

23. Option one is to retain the status quo. The existing thin capitalisation rules set minimum equity requirements for banking groups for tax purposes. The current tax requirements are significantly lower than prudential capital requirements for banks. As a result, there are opportunities to use debt from overseas parts of the group to reduce tax payable in New Zealand.

Option Two – Raise the thin capitalisation threshold to align closely with prudential capital requirements

24. Option two is to increase the thin capitalisation rules requirements to align more closely with prudential capital requirements announced by the Reserve Bank in December 2025, without explicitly linking it[8]. This will limit the opportunities to use debt from overseas parts of the group to reduce tax payable in New Zealand. This option would also raise approximately $45m over the forecast period and approximately $15m per year for outyears.

25. Take the example above of a locally incorporated bank with a New Zealand holding company. The bank has $12 of Tier 1 Capital and $100 of risk-weighted assets. The bank's New Zealand holding company has $6 of equity and$ 6 of debt owing to overseas group members. The proceeds of the equity and debt were used to pay the bank $12 for shares issued to the holding company. If the thin capitalisation threshold increased to 12%, the holding company would either need to replace the debt funding with capital, or it would be effectively denied a deduction for interest on the excess debt.

26. The Reserve Bank's prudential capital requirements are the most relevant commercial settings in a New Zealand banking context. Banks will transition to the requirements announced in December 2025 between now and when they come into effect.

27. Different capital requirements would apply for different sized banks in line with the Reserve Bank's approach to prudential regulation. The threshold for groups that include a domestic systemically important bank would be set at 12%[9], and for other groups would be set 11%[10].

28. The changes would also provide for temporary variations to these tax requirements when the Reserve Bank makes changes to the prudential capital requirements in times of systemic stress, to maintain alignment with commercial settings in these periods. These threshold variations will automatically align exactly with the variations made by the Reserve Bank.

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[8] As noted in paragraph 5, an explicit link would tie the government's hands in responding to changes in the banking environment.

[9] Equivalent to the Tier 1 Capital requirement (including the capital buffer) for domestic systemically important banks announced in December 2025.

[10] Equivalent to the Tier 1 Capital requirement (including the capital buffer) for group 2 deposit takers announced in December 2025.

How do the options compare to the status quo/counterfactual?

	Option One – Retain the status quo	Option Two – Raise the thin capitalisation threshold to align closely with prudential capital requirements
Revenue integrity	0	++ + Protects existing revenue due to equity levels being above current thin capitalisation threshold (approximately $240m of revenue per annum protected). + Raises additional revenue ($45m of revenue over forecast period and $15m for outyears).
Efficiency	0	- - Minor increase in tax costs(but this should mostly be offset by reduced tax costs overseas). - Theoretical reduction in incentives to invest in New Zealand.
Compliance costs	0	- - Minor transitional costs for those that need to increase equity. 0 Ongoing costs are expected to be minimal as banking groups already have systems in place for monitoring.
Coherence	0	+ + Updates a threshold in an existing regime to a commercial level increasing alignment with original policy intent. + Supports prudential settings.
Overall assessment	0	+

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

29. We consider that option two would be the most optimal and straightforward way to ensure that New Zealand banking groups are treated as holding a commercial level of capital for tax purposes.

30. This option will provide the key revenue integrity benefit, limiting opportunities for foreign-owned banking groups to use debt from overseas parts of a group to increase interest deductions and reduce tax payable in New Zealand. This will protect existing revenue of approximately $240m per annum that is collected due to bank equity levels being above the current thin capitalisation threshold. This amount would be protected against the risk of erosion from extra debt from overseas parts of banking groups in the future. It would also raise additional revenue of approximately $45m over the forecast period and $15m for outyears.

31. This option has some efficiency costs, however we consider these to be minor. While increasing the thin capitalisation threshold would increase tax costs for impacted banking groups, [redacted] And for those that are impacted, the increased tax costs would generally not be significant, and they should be substantially offset by reduced tax costs overseas due to a reduction in interest income in overseas parts of these groups, from the New Zealand part of these groups. Further, a risk is that some affected groups may seek to pass on increased tax costs to customers. However, this risk is expected to be limited, as affected groups would need to remain competitive with groups that are not affected. Any passthrough, if it occurred, would likely be partial and small.

32. An increase in the thin capitalisation threshold may in theory reduce incentives to invest in New Zealand. However, as the settings would broadly align with international prudential capital requirements, we consider this would not materially influence these incentives or restrict market competition.

33. Aligning with New Zealand prudential capital requirements, including different thresholds for groups based on size, will support prudential settings for the market.

34. This option also has some compliance costs, however we consider these to be minor too. There may be minor transitional costs for some banks in restructuring their balance sheets (by converting existing tax debt into tax equity) to meet the new requirements. However, ongoing compliance costs would be minimal, as banking groups already have systems in place for monitoring their tax equity position under the current rules.

35. This option will improve coherence of the tax system, by updating a threshold in an existing regime to a commercial level which aligns with the original policy intention.

36. We consider that the revenue integrity benefits and coherence benefits outweigh the efficiency costs and compliance costs.

Is the Minister's preferred option in the Cabinet paper the same as the agency's preferred option in the RIS?

37. The Minister's preferred option and Inland Revenue's preferred option are the same.

What are the marginal costs and benefits of the preferred option in the Cabinet paper?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups (foreign-owned New Zealand banking groups)	Increase in tax costs and minor one-off increase in compliance costs for some groups.	$45m cost over the forecast period (and $15m per year for outyears). Noting that this amount could be offset by reduced tax overseas.	High. The tax cost impacts were calculated using data in thin capitalisation calculations provided to Inland Revenue by banks.
Total monetised costs		$45m	High
Non-monetised costs		NA	
Additional benefits of the preferred option compared to taking no action			
Regulators	Lining up tax requirements with commercial settings aligns with the policy intention. Alignment with prudential capital requirements will support prudential market settings and also reduce the need for tax enforcement activity.	Medium	High. The original policy intention is clear from the policy documents supporting the introduction of the thin capitalisation regime.
Wider govt (base protection)	Protects $240m of tax revenue from the risk of erosion where equity levels are currently above the thin capitalisation threshold.	High	High. The revenue protected was calculated using data in thin capitalisation calculations provided to Inland Revenue by banks.
Wider govt (revenue raised)	Lowers tax deductions in New Zealand and	$45m benefit over the forecast period (and	High. The revenue benefits

	raises tax revenue by requiring banks to increase their equity to a commercial level.	$15m per year for outyears)	were calculated using data in thin capitalisation calculations provided to Inland Revenue by banks.
Total monetised benefits		$45m	High
Non-monetised benefits		High	High

Section 3: Delivering an option

How will the proposal be implemented?

38. If approved the changes would come into force on 1 April 2027. They would be included in the next omnibus tax Bill scheduled for introduction in the second half of 2026.

39. This approach will give time to engage further with banks on the changes. It will also give banks notice of the changes and time to prepare for them.

40. Inland Revenue will be responsible for the implementation and administration of the updated rules. Guidance will be published by Inland Revenue explaining the changes. There are no significant systems changes required as a result of this proposal.

How will the proposal be monitored, evaluated, and reviewed?

41. Once the changes are implemented, Inland Revenue will monitor compliance with the new rules through our normal taxpayer compliance management activities. Findings on compliance activity cannot be published due to taxpayer secrecy requirements.

42. Stakeholders will have opportunities to raise concerns through Inland Revenue's regular stakeholder engagement processes and compliance management processes.