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Amending the FIF rules for migrants
C/- Deputy Commissioner, Policy
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Dear Sir,

Submissions on "Amending the FIF rules for migrants"

Angel Association New Zealand (AANZ) welcomes the opportunity to provide feedback on Inland Revenue's Foreign Investment fund (FIF) issues paper. This submission aims to improve the alignment between New Zealand's immigration goals and tax policies, with a specific focus on how the FIF rules affect globally mobile talent.

Angel Association New Zealand plays a vital role in supporting early-stage investors, helping them maximize their potential to drive the growth of innovative startups, recognizing the critical role these investors play in shaping the future of Aotearoa New Zealand's economy. AANZ represents over eight hundred early-stage investors who invest approximately $200m annually in globally relevant young companies destined to export products and services to the world, driving economic growth and contributing to a prosperous future for New Zealand.

When the FIF rules discourages highly mobile talent, the impact goes beyond just lost FIF revenue, encompassing missed economic activity, reduced knowledge sharing, and hindered ecosystem development. Global talent is increasingly mobile, with other countries offering more tax-friendly environments for repatriating entrepreneurs and investors. If New Zealand wants to stay competitive and create an environment that attracts highly skilled talent, it needs to update its policies to better reflect international norms.

While access to capital is crucial for startups, access to human capital—specifically, experience, networks, and a deep understanding of international markets—is equally important. In many cases, it is this expertise that can make the difference between success and failure for a startup. For New Zealand companies aiming to scale globally from day one, the ability to tap into international experience, connections, and markets is vital.

Attracting highly skilled migrant investors to New Zealand is essential, not only to invest in but also to help nurture and grow our high-tech companies. Adjusting the FIF rules to make New Zealand a more attractive destination for these investors would be a key driver of economic growth.

However, the proposed changes appear to focus primarily on highly skilled migrant investors, without considering the significant value that highly skilled and experienced Kiwi expats bring. Many of these individuals have developed expertise in offshore markets, with experience founding and growing startups in places like Silicon Valley, investing in startups globally, and offering mentorship to companies with international aspirations. By limiting the scope of this review to only investor migrants, a substantial pool of international talent—who could contribute significantly to New Zealand's growth—is overlooked.

There have been a few notable instances where New Zealand expats—particularly those who have had significant international experience—have expressed frustrations about the challenges of returning to New Zealand due to the FIF rules. While specific names may not always be widely published, there are general examples of Kiwi expats in the tech and investment sectors who have highlighted the issue publicly.

For example:

1. **Tech Entrepreneurs and Investors**: Some high-profile Kiwi tech entrepreneurs and investors, particularly those with ties to Silicon Valley, have shared that the FIF rules pose a barrier to returning to New Zealand. Their concerns often focus on the tax treatment of their overseas income, which under the FIF regime can be onerous and discourage repatriation and are not aligned with the international mobility of talent.

2. **Global Startup Mentors**: Many Kiwi expats who have launched successful startups abroad, especially in regions with thriving startup ecosystems like the U.S. or Europe, have expressed an interest in returning to New Zealand to invest, mentor, or launch new ventures. However, they often mention that the tax burden associated with the FIF regime prevents them from doing so. These individuals emphasize that they are more likely to invest in startups overseas rather than New Zealand if they cannot return without facing significant tax implications on their global income.

This sentiment has been echoed by New Zealanders in the global business and investment communities. They argue that the FIF rules act as a deterrent, not only for returning home but also for considering New Zealand as an attractive destination for global investors and talent.

Taxation on paper gains will reduce the pool of potential experience offshore kiwi angel investors and venture capitalists returning to New Zealand leading to long-term impacts on New Zealand's startup ecosystem. These investors are essential in providing the initial capital and experience to help early-stage companies scale. Kiwi expats who want to return may instead choose to stay in their current country or move to more taxefficient jurisdictions. This could result in New Zealand missing out on valuable investment and talent. The potential consequences on startup growth if high-net-worth individuals and experienced investors are discouraged from returning will result in fewer successful startups reaching international scale, which would limit New Zealand's ability to increase its export revenue and attract more foreign investment.

It is proposed that the scope of the review be expanded to include kiwi expats who are wishing to return home to New Zealand and contribute their expertise and experience to growing New Zealand's economy.

The current FIF rules can disincentivise expatriates from returning to New Zealand if they have accumulated significant FIF interests abroad, especially if those investments are passive (e.g., shares in companies that don't pay dividends). For expats who hold illiquid investments (such as shares in start-ups), this can be a major issue, as they may be required to pay tax on unrealized income. Being taxed on the deemed income from their foreign investments, even without cash flow (i.e., no dividends or sales), creates a financial burden that discourages them from returning to New Zealand.

The review is concerned exclusively with direct income interest in foreign companies—specifically, foreign shares. The issue is that the current FIF rules may create a disincentive for migrants and kiwi expats to come to or stay in New Zealand, especially when these shares are difficult to sell or do not provide income (like dividends).

Some foreign shares can be hard to value, especially those not listed on stock exchanges. This makes the FIF rules problematic, as they tax deemed income, regardless of whether they have received any actual income (like dividends). If the investment doesn't produce enough cash to cover the tax (for example, if it has minimal or no dividends), the individual would need to sell part of their holdings or borrow money to pay the tax.

This problem is particularly severe for illiquid shares, which are hard to sell or come with restrictions on when they can be sold, making it difficult for investors to raise cash to pay the tax. This can be exacerbated for kiwi expats who founded companies offshore and are extremely limited in their ability to dispose of any of their shares or influence the sale process of the company.

It is proposed that illiquid shares should only be taxed on a realisation basis (taxing them only when the shares are sold or income is realized), as opposed to taxing them annually based on deemed income.

The transitional resident rules under the FIF regime offer a tax concession for New Zealanders returning after being abroad for at least 10 years. This exemption lasts for 4 years, after which individuals are treated as regular New Zealand residents and must pay tax on their worldwide income, including foreign investments. While this system aims to attract skilled expats by easing the tax burden during their initial years back in New Zealand, it can lead to significant tax liabilities on foreign income, particularly for those with substantial overseas investments.

For transitional residents holding shares in startup companies, the FIF rules present challenges as they require the valuation of foreign shares for tax purposes. Startups are often illiquid, and their valuations can be difficult to determine, especially for early-stage or private companies. As subsequent investment rounds increase the paper value of shares, expats may face taxation on notional income based on these valuations, despite having no actual cash flow. The inherent volatility and binary nature of startups—where most fail or take years to yield returns—makes annual taxation on paper values problematic, as these valuations can drop to zero.

The four-year exemption period does not align with typical startup timelines, where liquidity events may not occur for a decade. This mismatch can create significant tax liabilities for transitional residents once the exemption ends, even if their startup investments have not yet yielded returns. The transition from tax exemption to full taxation could result in sudden, large tax burdens, potentially driving expats and investors away from New Zealand, taking both capital and valuable expertise with them.

The FIF rules' treatment of startup shares and the 4-year transitional residency period pose significant challenges. These include difficulties in valuing shares, taxation of unrealized gains, and the potential disincentive for investment in high-growth businesses. The rules for transitional residents, might affect entrepreneurial intentions among Kiwi expats as successful returnees may be deterred from founding new startups in New Zealand due to the tax on unrealized income, leading to broader economic consequences. Adjusting the rules to better align with startup timelines would help retain global talent and foster a thriving startup ecosystem in New Zealand.

It is proposed that both the 4-year transitional residency and 10-year non-residency periods be reconsidered to better encourage Kiwi expats to return to and remain in New Zealand.

In summary, we propose the following:

1. The proposal should be expanded to include Kiwi expats who wish to return to New Zealand after achieving success abroad, bringing with them valuable experience and human capital.
2. Illiquid investments should only be taxed upon realisation, not on deemed income. Realisation events provide liquidity, enabling investors to meet their tax obligations.
3. The transitional residency period should be reviewed to better accommodate the long-term, illiquid nature of startups, where liquidity events may not occur for a decade or more.
4. The non-resident timeframe should be shortened for Kiwi expats with family commitments, allowing for a return to New Zealand within the 10-year period.

The purpose of the proposed changes are to ensure that New Zealand's tax policies are more aligned with internation norms, aiming to improve New Zealand's attractiveness as a destination for foreign investment, entrepreneurs and skilled professionals whether they be highly skilled migrants, or highly skilled and successful kiwi expats wanting to return home.

Bridget Unsworth
Chief Executive
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