Inland Revenue
Te Tari Taake

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA - MŌ TE TĀKUPU ME TE MATAPAKI ANAKE

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FACT SHEET | PUKA MEKA

Income tax – Share investments (whether the FIF rules apply)

Issued | Tukuna: Issue Date

IS ##/## FS #

This fact sheet accompanies IS XX/XX **Income tax – Share investments** which considers the income tax issues that arise for individual share investors. This fact sheet explains when and how the Foreign Investment Fund (FIF) rules will apply to shares you hold in foreign companies.

DRAFT

Introduction | Whakataki

1. This fact sheet explains when and how the FIF rules apply to shares you hold in foreign companies. If the FIF rules apply, you choose a method to calculate your income from your foreign investments. These rules can treat you as deriving income (even if you have not received anything) or may ignore returns that you have received, depending on the method you use.

2. If the FIF rules do not apply, the ordinary tax rules apply. For more information on how the ordinary tax rules apply, see FS xx/xx **Income tax – Share investments (dividends and taxable share sales)**.

Working out whether the FIF rules apply

3. Apply the following steps to find out how the tax rules apply to your situation.

Step one – are you New Zealand tax resident?

4. Different rules apply to a New Zealand tax resident, transitional resident or non-resident. The FIF rules apply only to a New Zealand tax resident.

> A **transitional resident** is a person who has:
>
> - recently moved to New Zealand for the first time, or
> - returned to New Zealand after being resident elsewhere for 10 years or more.
>
> The period of transitional residency is essentially four years from becoming resident in New Zealand.
>
> See Inland Revenue's website for more criteria: Temporary tax exemption.

5. If you are a transitional resident or if you are not tax resident in New Zealand, you do not have FIF income (and you also do not need to pay tax in New Zealand on dividends from foreign companies or on sales of shares in foreign companies); you just apply the ordinary tax rules to your New Zealand sourced income. This includes:

   - dividends received from a New Zealand company;
   - amounts received from a business carried on in New Zealand; or

- taxable sales of shares in a New Zealand company.

6. If you are a New Zealand tax resident, then move on to step two. A transitional resident whose transitional residency period has ended will also need to move on to step two.

Step two – do the FIF rules apply to you?

7. You now work out whether you hold attributing interests in FIFs that **added together** cost you more than $50,000. You only add attributing interests, you do not add in the cost of any exempt interests.

> An **attributing interest** in a FIF includes**:**
>
> - shares in a foreign company
> - an interest in a foreign superannuation scheme
> - a right to benefit from a life insurance policy issued by a FIF
>
> It does not include exempt interests. Most commonly these are shares in:
>
> - a New Zealand company or
> - some Australian companies (see Foreign Investment Fund Australian listed share exemption tool for more information).
>
> For other exemptions that may apply, see the table at page 6 of IR461-Guide to Foreign Investment Funds. If you have exempt interests, you don't apply the FIF rules, but you apply the ordinary tax rules to those interests.

8. If at any time during the income year you hold attributing interests in FIFs (such as foreign shares) that added together cost you more than $50,000 to buy, then you are in the FIF rules for that year. When applying this test to foreign shares you hold, it is what you paid to acquire the shares, not their market value on any day, that matters.

9. If you jointly own attributing interests with your partner or spouse, your share of the cost of those interests is included in the calculation. The cost of your share of the joint holdings is added to the cost of any attributing interests you may separately hold.

10. If the FIF rules apply to you, you need to calculate and include FIF income in your IR 3 individual income tax return and file an IR1261 overseas income summary to declare your overseas income sources. For more information on filing an IR1261 see Inland

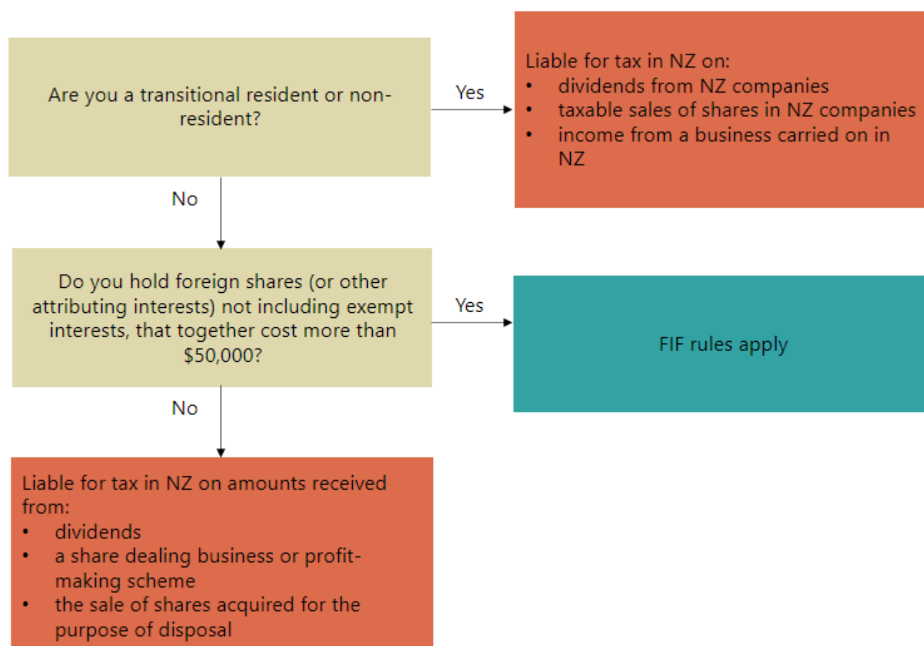
Revenue's website: Reporting your overseas income. You do not apply the ordinary tax rules to any income you receive from your FIF interests.

11. In some situations, you may need to file a FIF disclosure. However, generally, you do not need to file a FIF disclosure where you are an individual and:

- you hold less than 10% of the interests (for example, shares) in a foreign company;
- the company is incorporated in a country with a double tax agreement with New Zealand (for example, the United States); and
- you use the fair dividend rate or comparative value methods to calculate your FIF income (discussed below).

12. If you hold attributing interests in a FIF that added together cost $50,000 or less, you may choose to apply the FIF rules if you wish.

13. The application of these steps is illustrated in the following diagram.



Working out how the FIF rules apply

14. The FIF rules operate differently to ordinary tax rules. In some situations, even if you have not received any returns or gains, you may be treated as if you had. Also, any actual returns or gains you did receive may be ignored, depending on the FIF method you use.

15. FIF income is calculated using one of five methods that you choose to use (subject to some limitations). These methods are the:
    - fair dividend rate (FDR) method;
    - comparative value (CV) method;
    - cost method;
    - attributable FIF income method; or
    - the deemed rate of return method.
16. For an explanation of the methods you may use and how to calculate your FIF income, see the table at page 11 of the IR461 Guide to FIFs and the explanation from page 14.
17. You choose a method by undertaking the calculations and returning the relevant amount of income in your IR 3 individual income tax return.
18. The most common method is the FDR method. If you use the FDR method, you are generally taxed on 5% of the opening market value of your foreign shares (or other attributing interests). The opening value is the value of your shares at the start of the income year (for example, 1 April). Dividends and gains from the sales of shares are usually not taxed under this method. However, when there is a "quick sale" (that is, if you buy and sell shares within a year) then a quick sale adjustment is required. How to do this is explained in more detail in the IR461 Guide to FIFs at page 15.
19. Another common method is the CV method. If you use the CV method, you calculate the closing market value of your shares (this is the value of your shares at the end of the income year, for example 31 March) plus any gains such as dividends and sales, and then you subtract the opening market value plus any costs.
20. As an individual, you can do the calculations under either of these methods and choose which one you would prefer to use, in each income year. A calculation tool is provided on Inland Revenue's website to do this: Calculate my foreign investment fund income. Calculating your income under the FIF rules can be complicated. If you are in the FIF rules you may want to consult a tax advisor to assist you with the calculations.
21. If you are not in the FIF rules (and do not choose to apply them), you are liable for tax in New Zealand on dividends and taxable share sales. See FS XX/XX **Income tax – Share investments (dividends and taxable share sales)** to determine whether you have a tax liability.

For more information on how the FIF rules apply see:

- Part two of IS XX/XX **Income tax – Share investments**;
- Inland Revenue's booklet on the FIF rules IR461-Guide to Foreign Investment Funds;
- Inland Revenue's website at Foreign investment funds (FIFs) to learn how to file your return and calculate your income; and
- QB 23/10 **Foreign investment fund (FIF) calculation methods in cases of non-compliance**.

22. The application of the FIF rules is illustrated in Example | Tauira 1.

Example | Tauira 1 – Attributing interests in a FIF exceed $50,000 in a year

Jax came into a windfall when their uncle left them $55,000 in a will. On 31 March 2022, Jax decided to invest this amount in ordinary shares in a variety of United States companies using an online investment platform.

Jax will be subject to the FIF rules because at a point in time in the 2022 income year Jax held attributing interests that had cost over $50,000. However, under the FDR method no income will arise as the opening value on 1 April 2021 was zero.

For the 2023 income year, Jax had not sold any shares and is still subject to the FIF rules. Jax uses Inland Revenue's calculation tool to work out their FIF income. Jax works out that under the FDR method they have deemed income of $2,750 (opening market value of $55,000 multiplied by 5% with no quick sale adjustments).

As a natural person, Jax can compare the result under the FDR method with the CV method and choose which method to use. As at 31 March 2023, the value of Jax's shares had increased to NZ$59,125. Jax had received no dividends and made no sales. Under the CV method, Jax's FIF income would be $4,125 ($59,125 - $55,000). Jax chooses to use the FDR method. Jax can make this choice again in the following income year if the FIF rules still apply.

Jax will need to complete the IR 1261 overseas income summary but does not need to file a FIF disclosure.

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