Inland Revenue
Te Tari Taake

FACT SHEET | PUKA MEKA

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

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IS 24/10 FS 1

This fact sheet accompanies IS 24/10 **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 an individual investor holds in foreign companies.

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 do not apply the ordinary tax rules in relation to any dividends you receive or share sales. Instead, 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. Unless otherwise stated, all amounts are in New Zealand dollars.

2. If the FIF rules do not apply, the ordinary tax rules apply. For more information on how the ordinary tax rules apply, see IS 24/10 FS 2 **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 a 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.
>
> There are some exceptions such as when a person claims a Working for Families tax credit. A person can also choose to opt out of being a transitional resident. 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 to buy. You only add attributing interests, you do not add in the cost of any exempt interests. If you have exempt interests, you don't apply the FIF rules, but you still apply the ordinary tax rules to those interests.

An **attributing interest** in a FIF includes**:**

- shares in a foreign company or a unit trust
- 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 Inland Revenue's Foreign Investment Fund Australian listed share exemption tool for more information).

For other exemptions that may apply, see the table at page 6 of Inland Revenue's Guide to FIFs Foreign investment funds (FIFs).

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 in New Zealand dollars when you acquired the shares, (including any transaction fees) not their market value on any day that matters. You may also choose to apply the FIF rules if you hold attributing interests that added together cost you less than $50,000 to buy.

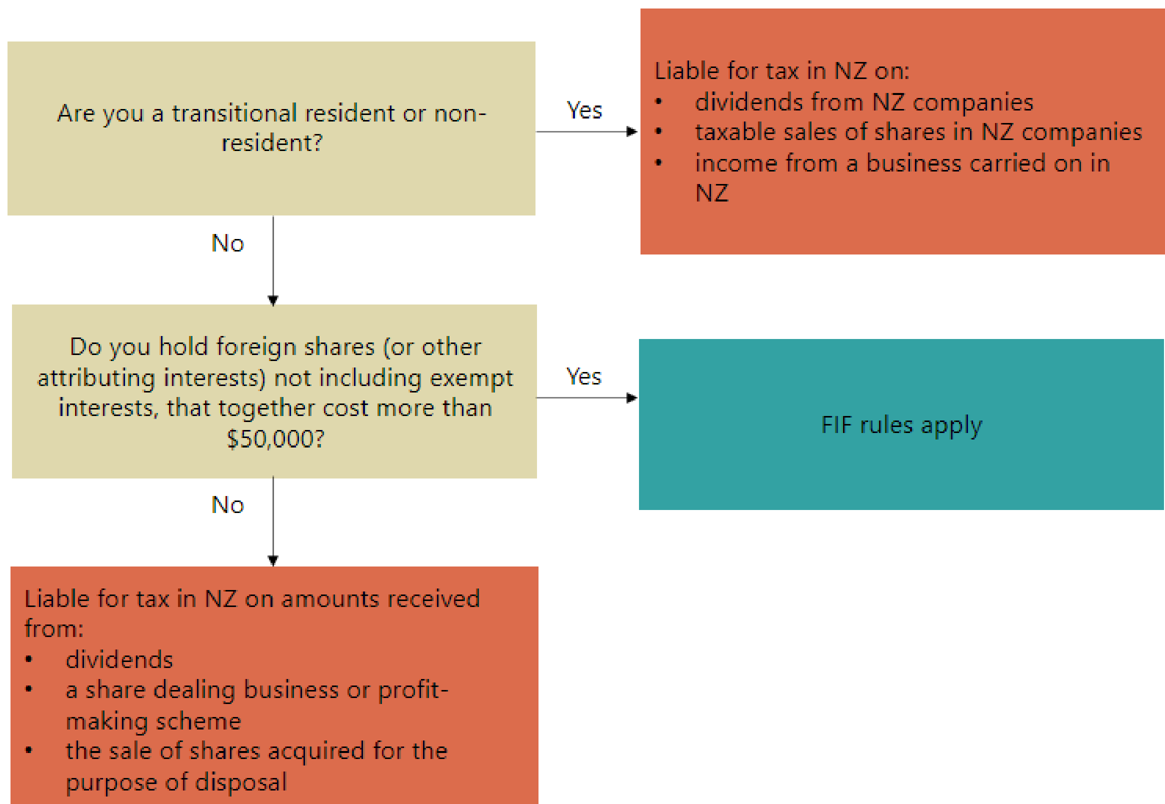
9. If you jointly own attributing interests with your partner or spouse, your share of the cost of those interests is included in the calculation. The cost of your share of the joint holdings is added to the cost of any attributing interests you may separately hold.

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 and claim foreign tax credits. 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. The application of these steps is illustrated in the following diagram.



Working out how the FIF rules apply

13. 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.

14. 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
    - deemed rate of return method.

15. For an explanation of the methods you may use and how to calculate your FIF income, see the table in Inland Revenue's Guide to FIFs (IR461).

16. You choose a method by undertaking the calculations and returning the relevant amount of income in your IR 3 individual income tax return. Each year you may choose a different applicable FIF method, but you must consistently use the same FIF method across all your attributing interests for that year.

17. 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, which for individuals is 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 Inland Revenue's Guide to FIFs (IR461).

18. 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, which is 31 March) plus any gains such as dividends and sales, and then you subtract the opening market value plus any costs.

19. 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.

20. 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 IS 24/10 FS 2 **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 24/10 **Income tax – Share investments**;
- Inland Revenue's website at Foreign investment funds (FIFs) to learn how to file your return and calculate your income; and
- Inland Revenue's Guide to the FIF rules (IR461)
- QB 23/10 **Foreign investment fund (FIF) calculation methods in cases of non-compliance**.
- For information on claiming foreign tax credits, see IS 21/09 - **Income tax – foreign tax credits – how to calculate a foreign tax credit.**

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.

2022 income year

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

2023 income year

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 (and must use the same method across all FIF investments). Jax will need to complete the IR 1261 overseas income summary but does not need to file a FIF disclosure.

2024 income year

In January 2024, the shares had increased in value to $64,300 and Jax decided to sell half the interests and invest those funds into exempt Australian shares. Jax is still subject to the FIF rules in the 2024 income year because at a point in time, Jax held attributing interests that cost more than $50,000.

Jax will need to undertake the same calculations as for the previous year and complete the IR 1261 overseas income summary.

2025 income year

If Jax did not acquire any further attributing interests, the FIF rules do not apply.

Expenses related to attributing interests in FIFs

23. You may incur various expenses when you invest in shares, (such as the cost of acquiring the shares, fees and interest on funds borrowed to buy shares). Deductibility of these expenses depends on whether there is a relevant nexus with income and also whether the expenses are capital in nature.

24. If your investments are subject to the FIF rules, you derive FIF income. This means that expenses related to your attributing interests will have the relevant nexus with income. However, deductions for the cost of shares, including brokerage or platform fees incurred to acquire the shares, cannot be claimed when the FIF rules apply (except where the amount is taken into account in the relevant FIF calculation method).

25. You can also deduct interest on borrowed funds used to acquire your FIF interests. You will need to be able to show that the borrowed funds were used to purchase the shares. This could include a contemporaneous bank statement showing the funds leaving the loan account and a buy order for shares of the same amount.

26. If you use the same facility for buying shares and for other investments or expenses, you need to be able to prove the amount of interest that relates to the shares. This can be difficult where a facility is used for multiple uses and where there are repayments and new drawdowns. To ensure you can prove that interest is deductible, if possible, it would be advisable to keep borrowings for shares and for other investments or expenses separate.

About this document | Mō tēnei tuhinga

Some of the Tax Counsel Office's longer or more complex items are accompanied by a fact sheet that summarises and explains an item's main points. While it summarises the Commissioner's considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further Status of Commissioner's advice (Commissioner's Statement, Inland Revenue, December 2012*)*.