Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Changing FIF calculation methods

Decision date | Rā o te Whakatau: 17 March 2023

Issue date | Rā Tuku: 17 October 2023

TDS 23/13

DISCLAIMER | Kupu Whakatūpato

This document is a summary of the original technical decision so it may not contain all the facts or assumptions relevant to that decision.

This document is made available for **information only** and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs.** It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

For more information refer to the Technical decision summaries guidelines.

Subjects | Kaupapa

Changing FIF calculation methods; fair dividend rate method; comparative value method.

Taxation laws | Ture tāke

All legislative references are to Income Tax Act 2007 (the Act).

Facts | Meka

1. The Arrangement involves a Trust and a Company (the Applicants) seeking to change their foreign investment fund (FIF) calculation methods.
2. The Applicants have an interest in a number of foreign unit trusts and companies (the relevant FIFs). The relevant FIFs are not tax residents for New Zealand tax purposes under subpart YD and are not treated as being tax residents of New Zealand under any double tax agreement.
3. The Applicants have returned FIF income under the attributable FIF method (s EX 46(3)) in relation to their interests in the relevant FIFs from the beginning of their investment.
4. The assets of each FIF (or the FIF itself) have been sold. The Applicants have received distributions from the sale over two income years (the relevant income years).
5. The Applicants have not yet been required to file their tax returns for the relevant income years at the time of this ruling.
6. The FIF rules apply to the relevant FIFs as follows:
   - The rights held in the foreign unit trusts are each an "attributing interest" in a FIF under s EX 29 and none of the exemptions in ss EX 31 to EX 43 apply.
   - The rights are not exempt from being an attributing interest in a FIF under any of the categories listed in s CQ 5(1)(c).
   - The Applicants have not changed the FIF calculation method they each have used since the beginning of their investments in each FIF.
   - None of the requirements described in s EX 46(10) are met. Therefore, the interests held by the Applicants in the FIFs do not relate to a non-ordinary share.
   - The requirements of s CQ 5(5) are not met in relation to the Trust.
   - The Company is not required to use the fair dividend rate periodic method by s EX 52A(2).

This summary is provided for information only and is not binding on the Commissioner. See page 1 for details.

Issues | Take

7. The issues considered in this ruling were:

   - whether the Applicants can change their FIF calculation methods for the relevant income years;
   - whether the Applicants can choose to use the fair dividend rate (FDR) calculation method to calculate their FIF income for the relevant income years; and
   - whether the comparative value (CV) calculation method is also available to the Trust for the relevant income years.

Decisions | Whakatau

8. The Tax Counsel Office (TCO) concluded that:

   - the Applicants can change their FIF calculation methods for the relevant income years;
   - the Applicants can choose to use the FDR calculation method for the relevant income years; and
   - the CV method is also available to the Trust.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Changing FIF calculation method

9. Under s EX 62(1), once a person uses a particular calculation method to calculate FIF income for an attributing interest in a FIF for a particular period, they must use the same method for interests in the FIF for the next period unless they are allowed to change under subsections (2) to (9).

10. The relevant permission is s EX 62(3), which provides that a person may change methods by notice to the Commissioner if:

    - the notice complies with s EX 62(4); and
    - the change is to or from the attributable FIF income method and within subsections (6) or (7).

11. Section EX 62(4) includes three relevant requirements that the notice must:

This summary is provided for information only and is not binding on the Commissioner. See page 1 for details.

- give the reasons for the change; and
- comply with the Commissioner's notice requirements; and
- be given before the end of the first income year or accounting period for which the change is to take place, unless the Commissioner agrees to a retrospective notice.

12. TCO considered that the Applicants comply with s EX 62(3) for these reasons:
    - The Commissioner has accepted that this ruling application constitutes notice for the purposes of s EX 62(3) and this notice complies with s EX 62(4).
    - Section EX 62(6) is satisfied as the Applicants have only returned FIF income using the attributable FIF method, and this is the first time they have chosen to change from this method for the relevant FIFs.
13. Therefore, TCO concluded that the Applicants have met the requirements of s EX 62 and are able to change their FIF calculation methods for the relevant income years.

Issue 2 | Take tuarua: Availability of the FDR method

14. TCO considered whether the Applicants can choose to use the FDR method to calculate their FIF income for the relevant income years.
15. Section EX 46 is the main provision for the availability of different FIF income calculation methods.
16. Section EX 46(1) provides that if a person has two or more attributing interests in the same FIF for the same period, the person must use the same calculation method for calculating FIF income from each interest, unless the choice of method is limited by this section.
17. Under s EX 46(8), a person is not able to use the FDR method for an attributing interest in a FIF that is a share in a foreign company if:
    - the share is a non-ordinary share (s EX 46(8)(a)); and/or
    - the person chooses to use the CV method for another attributing interest that is a share in a foreign company for which the person would be allowed to use the FDR method (s EX 46(8)(b)).
18. For the purposes of the Act, the foreign unit trusts and the units in those trusts are foreign companies and shares respectively.

This summary is provided for information only and is not binding on the Commissioner. See page 1 for details.

19. Given all attributing interests are shares in foreign companies, and the shares are not non-ordinary shares, TCO concluded that the Applicants can choose to use the FDR method in determining their income under the FIF rules for the relevant income years.

Issue 3 | Take tuatoru: Availability of the CV calculation method to the Trust

20. Under s EX 46(6), a person can use the CV method for an attributing interest in a FIF that is a share in a foreign company for an income year if certain criteria are met. As noted above, the attributing interests concerned are confirmed as shares in a foreign company.
21. To use the CV method, the Trust must meet at least one of the criteria in s EX 46(6)(a) – (e).
22. TCO considered that the Trust meets the criteria in s EX 46(6)(b) because, based on the facts in the ruling application:
    - The Trust is a New Zealand complying trust and has always been complying trust.
    - The Trust has no gifting settlor who is not a natural person or deceased person.
    - Since the Trust was established, it has been for the benefit of natural persons for whom the gifting settlors of the trust have natural love and affection.
    - The Trust is not superannuation scheme.
23. As a result, TCO concluded that the CV method would be available for the relevant income years.

Consequences of changing to the CV calculation method

24. If the Trust uses the CV method to calculate its FIF income in the relevant income years, the FIF income will be calculated in accordance with the formula in s EX 51:

    (closing value + gains) − (opening value + costs)

25. Relevantly, the definition of "opening value" in s EX 51(5) provides that the value is zero if the person was applying another calculation method to the FIF interest at the end of the previous income year.
26. Further, s EX 63 sets out the consequences for a person changing between a look-through method (attributable FIF income method) to a cost-based method (CV). Under s EX 63, the Trust will be treated as if:

This summary is provided for information only and is not binding on the Commissioner. See page 1 for details.

- it disposed of the interest to an unrelated person immediately before the start of the first relevant income year;
- it reacquired the interest at the start of the first income year;
- it received for the disposal and paid for the reacquisition, an amount equal to the interest's market value at the time.

27. As a result, for the first relevant income year:
    - The opening value of the Trust's relevant FIF interest is zero (s EX 51(5)).
    - The costs will include the market value at the start of the year (being expenditure that the person incurs in acquiring the interest) (s EX 51(6)(a)).

Application of s EX 46(1) and s EX 46(8)(b)

28. As mentioned in paragraph 16, a person must not use the FDR method to calculate FIF income if the person chooses to use the CV method for another attributing interest that is a share in a foreign company for which the person would be allowed to use the FDR method.
29. Given the Trust will be able to use either the FDR or the CV method to calculate its FIF income from the relevant interests, to ensure the ruling is consistent with ss EX 46(1) and EX 46(8)(b), the ruling is issued with the following proviso:
    - Where the Trust has two or more attributing interests in the same FIF in the same period, it uses the same calculation method for calculating the FIF income or loss from each interest in that FIF for that period (s EX 46(1)).
    - The Trust uses either the CV or the FDR method to calculate its FIF income for all the FIF interests in the relevant FIFs for each of the relevant income years (s EX 46(8)(b)).
    - If the Trust uses the CV method for determining its income under the FIF rules in the relevant income years, it does not use the FDR method in relation to any of its other FIF interests (s EX 46(8)(b)).
    - If the Trust uses the FDR method for determining its income under the FIF rules in the relevant income years, it does not use the CV method in relation to any of its other FIF interests (s EX 46(8)(b)).

This summary is provided for information only and is not binding on the Commissioner. See page 1 for details.