New Rules for Foreign Investment Funds (FIF)

New rules were legislated late last year affecting taxpayers holding shares in foreign companies or interests in foreign unit trusts.

The change is effective for tax years beginning on or after 1 April 2007 and relates to investments held in foreign countries that are less than 10% of the total shares/units issued by the foreign company/unit trust.

Rationale behind the change

The New Zealand Government aims to remove inconsistencies that exist in the taxation of investment income. An investor's decision to buy shares/units is distorted under the current tax laws because:

- Investments held directly by a person are taxed differently from indirect investments through a manager such as a unit trust.
- Income from New Zealand investments is treated differently for tax purposes than income from overseas investments.

In trying to deliver fairness to the taxing of investment income, the New Zealand government appears to have complicated this area of taxation further with the introduction of the new rules.

New Rules

The new rules:

- Do not change the way income from New Zealand companies is taxed;
- Remove the grey list exemption that applied to shareholding of less than 10%;
- Contain several exemptions including shares held in certain Australian companies (see below); and
- Introduce another method called the Fair Dividend Rate method (to the four existing methods) of calculating FIF income with restrictions on which method can be used.

The Fair Dividend Rate (FDR)

Put simply, the FDR method taxes 5% of the opening market value of investments in FIF entities plus an adjustment for quick sales during the year. Hence, for the year ended 31 March 2008, the market value of shares on 1 April 2007 will be taken into the calculation. The quick sales adjustment applies to shares/units that are purchased and sold in the same year in relation to a particular investment.

De Minimus Exemption

Individuals are exempt from the new rules if the cost of their investment is $50,000 or less.

The $50,000 cost exemption is also extended to trusts that:

- Arise out of a Court order; or
- Are estates but only for the first five income tax years after death; or
- Have ACC as the settlor.

Australian Exemption

Shares held in certain Australian companies that are listed (top 500 companies) on the Australian Stock Exchange will be exempt from this regime provided:

- They are required to maintain a Franking Credit account; and
- They are resident in Australia or New Zealand all year under the Double Tax Agreement.

These investments will be treated the same way as New Zealand share investments.
Certain Australian resident unit trusts are also exempt and are treated for tax purposes the same way as New Zealand share investments.

The foregoing is to be treated as information only and clients are strongly recommended to seek professional advice on investments in FIFs before taking any action.

Recent IRD Developments

- The treatment for **excess imputation credits** has changed – they are now carried forward rather than converted to a deemed loss.

- **Kiwisaver** Employer Guides (KS 4) and Employee Information Packs (KS 3) will be mailed to employers from mid May.

  For further information visit www.ird.govt.nz/kiwisaver/employers

- IRD have updated the **general depreciation rates guide** (IR 265) – this is now available under the forms and guides section of the IRD website.

- IRD have changed the format of GST returns and will now use imaging machines to read returns. **Be careful** to fill in amounts correctly as the machine will always add a decimal point two digits from the right.

  It may be a good time to consider e-filing your GST returns.

- IRD have released an official issues paper regarding the **association rules**. The paper contains suggestions for closing loopholes in the definitions – in particular it looks at the use of Trusts and the roles of Settlors and Trustees.

  Clients who have employed Trust structures to avoid association for property development (commonly referred to as "tainting") should watch this space – but don't panic just yet.

- A taxation bill will be introduced in May relating to the adoption of International Financial Reporting Standards **(IFRS)**.

  To quote Peter Dunne MP
  "Once enacted, the tax changes will apply from the year a taxpayer adopts IFRS, so will be retrospective for some taxpayers," Mr Dunne said.

  "The main legislative change in the bill will be a more explicit adherence to the IFRS recognition of income and expenditure from financial arrangements".

  "For financial arrangements, however, early adopters will be able to use the existing financial arrangement rules and pre-IFRS accounting practice for the relevant years, but must adopt IFRS for tax purposes from the 2007-08 income year".