

NEW ZEALAND TAX UPDATE

[AS AT 1 JULY 2011]

1. New Zealand and Hong Kong entered into a Double Tax Agreement [**DTA**] which was signed on 1 December 2010. That Agreement will come into force when ratified by each country. It will not apply before 1 April 2012. If the Treaty provisions impact on this *Update*, an amendment will be incorporated.
2. NZ imposes income tax on a residency/source basis. It taxes residents on total worldwide income. It taxes non-residents on NZ sourced income only.
3. There is a four year domestic income tax exemption in respect to foreign sourced income (other than employment or services income) available for overseas individuals who become tax resident. The exemption is not available if the person has been an NZ tax resident within the previous 10 years.
4. Individuals are resident in NZ if they have a *permanent place of abode* (effectively one's home) in NZ. There is a second test of *tax residency*. An individual is deemed resident if they have spent more than 183 days in total in any **continuous** 12 month period in NZ. If this test is met, tax residency commences from the first day of the 183 day period.
5. A company is resident if it is incorporated in New Zealand or its head office, centre of management or the place from which directors exercise control is situated in NZ.
6. The residence of a trust is determined by the residence of *its* settlors.
7. Foreign sourced income is subject to NZ tax at the taxpayer's marginal tax rate. Foreign tax paid is available as a credit up to the equivalent NZ tax imposed. Non-resident withholding tax [**NRWT**] deducted from passive income (interest/dividends) is generally available in full as a credit. This is provided either by way of a double tax treaty or domestic tax legislation. Imputation credits attached to foreign dividends are not available as a tax credit.

NZ adopts a comprehensive international tax regime under which NZ residents are subject to New Zealand tax [in respect to foreign investments] under either the *Foreign Investment Fund* [**FIF**] or *Controlled Foreign Corporation* [**CFC**] regimes. Under the CFC regime, foreign sourced income of a foreign company controlled by NZ shareholders is attributed back to the NZ resident shareholder. However, where a CFC generates active income (as opposed to passive income such as interest), that active income will not be reported for New Zealand taxation purposes; nor attributed to the NZ shareholders of the foreign company.

Where an NZ resident has an interest in a FIF there is a requirement to calculate and return income attributable to that interest. Thus income is taxed as it is earned.

A person has FIF income if inter alia that person has rights in a foreign company, foreign superannuation scheme, rights under a life insurance policy issued by a non-resident and such rights/entitlement are not otherwise exempted or fall within the

CFC regime.

8. Dividends derived by a NZ resident individual from a foreign company (not subject to FIF rules) are subject to NZ income tax on the gross dividend. Credit is available for foreign tax paid up to the equivalent New Zealand tax. Reference needs to be made to any double tax agreement for any variation to the above. Insofar as NZ/HK is concerned, *Article 10* [when the **DTA** comes into force] is the relevant Article dealing with dividends.
9. Under FIF Rules, and where an investor owns less than 10% of a foreign company, with respect to foreign dividends, NZ has introduced a *fair dividend rate* [**FDR**] regime. The **FDR** has been set at 5% and applies to portfolio investments in offshore shares and to the market value [MV] of such shares. Australian listed investments (in general) are excluded from the FDR regime. The FDR is deemed to be the return (including dividend) from the investment in the offshore shares on an annual basis.

Assume a taxpayer holds offshore shares with a market value [MV] of NZ\$100k at 1 April 2011. During the year the taxpayer acquires another NZ\$20k, which is held at 31 March 2012. During the year ended 31 March 2012, the taxpayer receives a dividend of NZ\$3k. Shares have a MV of NZ\$121k at 31 March 2012. Under **FDR** the taxpayer would be taxed on NZ\$5k (5% of NZ\$100k). However, if the taxpayer can show his actual return is less than NZ\$5k, he would be taxed on that lesser amount. In the illustration, the taxpayer has received dividends of NZ\$3k plus gain of NZ\$1k to equal NZ\$4k. As a result, tax would be imposed on NZ\$4k in the 2012 income year.

10. Unlike Australia, NZ does not have a capital gains tax [**CGT**] as such. There are certain transactions however (e.g. property dealers/developers and traders in equities), where any gain/loss is assessable/deductible.

There has been a great deal of recent publicity strongly suggesting that the Government ought to introduce such a CGT. It has been promoted by a tax working group [**TWG**]. So far it has been resisted by both parties (National and Labour). Despite recommendation from TWG, Government did not include a CGT in its May 2011 Budget.

11. Once an NZ expat or immigrant moves to NZ, they will become subject to NZ tax on their worldwide income (subject to the four year exemption).
12. An entitlement under a foreign superannuation scheme is prima facie subject to NZ tax. If received as a pension, the amount of the pension is taxable. If received otherwise, proceeds fall within the **FIF** regime. Certain exemptions can apply.
13. There is opportunity to establish a foreign trust as an investment vehicle prior to establishing NZ tax residency. Foreign sourced income of that trust can remain outside the NZ tax net until distributed to an NZ resident beneficiary.

Opportunity can be taken to make such distribution during the four year tax exemption period.

14. NZ residential property has been a favoured investment option for non-resident investors. Negative gearing allows losses to be offset against current and future assessable income. Gains from the sale of such investment properties are generally not liable to NZ tax.

There is no longer an entitlement to claim depreciation on commercial and residential buildings.

15. Refer attached schedule for current tax rate for individuals, companies and trusts.
16. NZ resident companies and NZ subsidiaries of a foreign company are taxed on net income after allowable deductions.
17. Non-resident withholding tax **[NRWT]** is charged on dividends, interest and royalties remitted from NZ to non-residents. The rate is generally 15% (interest/royalties) and 30% (dividends). In respect to countries with which NZ has a double tax treaty, NRWT is reduced to 15% (dividends) and 10% (interest/royalties).

NRWT is not deducted from the dividend paid where the company attaches full imputation credits.

NRWT on interest can be substituted with a 2% approved issuer levy which is payable by the borrower [the 2% itself is tax deductible]. This is not available where the parties (lender/borrower) are associated.

18. From 1 October 2010, investment in a *Portfolio Investment Entity [PIE]* allows returns to be taxed at a maximum 28%. Some investors will be taxed as low as 12.5%.

Currently there is legislation before Parliament that will allow non-residents investors in a PIE [where the underlying investment is outside New Zealand] to be taxed at a 0% rate. There is certain qualifying criteria which is beyond the scope of this article.

19. Advice/Warning

Migrants/returning expats do **need** to take professional advice prior to moving to NZ. Currently, New Zealand Inland Revenue are accessing New Zealand transactions using foreign credit card accounts. If the holder of those accounts has not filed a tax return, an enquiry letter results. In a number of cases, (I am dealing with 14 at present) migrants/returning expats have received entitlements (e.g. pension/lump sum payments/dividends/interest), which are not subject to tax in the country of source, but which are liable for tax in New Zealand.

Not only are those persons liable to the core NZ tax resulting, but late payment penalties from the date the tax was due, together with use of money interest (currently at a rate of 8.89%) is charged which compounds the ultimate liability. Worse still, if the New Zealand tax authorities are of the view that the non-filing of a New Zealand tax return was deliberate, additional shortfall penalties can apply.

There is opportunity to consider dealing with the likes of pensions/lump sum payment entitlement to avoid exposure to New Zealand taxation. A great number of these persons have not deliberately avoided filing a New Zealand tax return; and generally understood that because their entitlement was not taxable in (say) Hong Kong, it was not going to be taxable in NZ.

Disclaimer:

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Tax Rates

Company	Flat Rate	28.0%
Trustee		33.0%
Individuals	Income to \$14,000 pa	10.5%
	\$14,0001 - \$48,000	17.5%
	\$48,001 - \$70,000	30.0%
	Over \$70,000	33.0%

Nobody pays double tax