> **LJ 1 What this subpart does**
>
> *When tax credits allowed*
>
> (1) **This subpart provides the rules for dividing assessable income from foreign-sourced amounts into segments and allows a tax credit for foreign income tax paid in relation to a segment of that income**.
>
> *Limited application of rules*
>
> (2) The rules in this subpart apply only when—
>
> (a) a person resident in New Zealand derives assessable income that is sourced from outside New Zealand;... [Emphasis added]

92. Section LJ 2(1) to (3) provides:

> **LJ 2 Tax credits for foreign income tax**
>
> *Amount of credit*
>
> (1) **A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income,** determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.
>
> *Limitation on amount of credit*
>
> (2) The amount of the person's credit in subsection (1) must not be more than the amount of New Zealand tax payable by the person in relation to the segment calculated under section LJ 5(2), modified as necessary under section LJ 5(4).
>
> *Amount adjusted*
>
> (3) The amount of the person's credit in subsection (1) may be reduced or increased if either section LJ 6 or LJ 7 applies. [Emphasis added]

93. Section LJ 4 defines "segment of foreign-sourced income" as "a person has a **segment of foreign-sourced income** equal to an amount of assessable income derived from 1 foreign country that comes from 1 source or is of 1 nature" [original emphasis]. For example, a dividend derived by a New Zealand investor from a US LLC would be a segment of foreign-sourced income (along with any other dividends derived from the US) because it is an amount of assessable income they derived from one foreign country (the US) that comes from one source (the US LLC) or is of one nature (a dividend). This is modified by s LJ 2(7) for FIF attributing interests, such that each FIF attributing interest is a separate segment of foreign-sourced income. This means FIF attributing interests from the same country are not aggregated and calculations must be done for each individual interest.

94. A New Zealand investor may claim an FTC against New Zealand tax payable on that foreign-sourced dividend, for an "amount of foreign tax paid" on that segment of foreign-sourced income. The FTC claimable by the New Zealand investor cannot exceed the New Zealand tax payable in relation to the foreign-sourced dividend: s LJ 2(2).

95. Section LJ 2(1) and (2) does not apply to the arrangements in the Rulings for two reasons.

96. The first reason is that no US tax is paid on the dividend distributions (segment of foreign-sourced income) that are taxed in New Zealand.

97. The second reason is that a New Zealand investor pays US federal income tax on their distributive share of the US LLC's income. However, this cannot be claimed as an FTC against the New Zealand investor's dividend income derived from the US LLC, because that foreign tax is not paid "on" that segment of foreign-sourced income under s LJ 2(1). In other words, as the New Zealand investor's distributive share of the US LLC's income is not income derived for New Zealand tax purposes, there is no relevant segment of foreign-sourced income on which to claim an FTC in New Zealand.

98. We consider how the NZ–US DTA applies for US LLC investments from [120] to [128]. Article 22 of the NZ–US DTA operates in essentially the same way as ss LJ 1(1) and LJ 2(1) by permitting an FTC for foreign tax paid but only on the same income, for example, a foreign-sourced dividend taxed in New Zealand and in the US.

Section LJ 2(6) and (7) – special rule

99. Section LJ 2(6) and (7) provides:

> *When subsection (7) applies*
>
> (6) Subsection (7) applies to a person who derives an amount from an attributing interest in a FIF when the amount is treated as not being income under section EX 59(2) (Codes: comparative value method, deemed rate of return method, fair dividend rate method, and cost method).
>
> *Tax credit*
>
> (7) The person has a tax credit under this subpart for foreign income tax paid on or withheld in relation to the amount. The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the amount of FIF income from the attributing interest that the person derives in the period referred to in section EX 59(2).

100. Any FIF income calculated under the FDR, CV, CM or DRR calculation method is a substitute for actual income derived by a New Zealand investor in the FIF. To avoid

double taxation, any actual income derived from a FIF by a New Zealand investor who has chosen to adopt the FDR, CV, CM or DRR calculation method is excluded income under ss EX 59(2) and CX 57B (that is, it is not assessable income).

101. Notwithstanding this "exemption", the special rule in s LJ 2(6) and (7) provides that any foreign tax paid on such actual income derived by a New Zealand investor may be credited against their New Zealand tax liability on FIF income calculated under the FDR, CV, CM or DRR calculation method. For example, if a New Zealand investor derives a foreign-sourced amount that has been subject to foreign tax, then they can claim an FTC under s LJ 2(6) and (7) against their New Zealand tax liability on FIF income calculated under the FDR, CV, CM or DRR calculation method (but not exceeding the New Zealand tax applicable on the FIF income: s LJ 2(2)).

102. However, s LJ 2(6) and (7) does not apply to the distributions from the US LLC in the context of the arrangements in the Rulings, as no US tax is paid on the distributions from the US LLC that are dividends for New Zealand tax purposes. Section LJ 2(6) and (7) also does not apply in relation to any US federal income tax paid by a New Zealand investor in a US LLC on their distributive share of the US LLC's income. That "partnership" income is not income derived by the New Zealand investor for New Zealand tax purposes.

Subpart LK – CFC and FIF income

103. Where a person has attributed CFC income or applies the AFIM to their FIF interest, then that person is entitled to an FTC under s LK 1 against their New Zealand CFC or FIF income tax liability.

104. Section LK 1(1) provides:

> **LK 1 Tax credits relating to attributed CFC income**
>
> *When tax credits allowed*
>
> (1) A person who has an amount of attributed CFC income for an income year has a tax credit for the tax year corresponding to the income year equal to the following amounts paid or payable in relation to the attributed CFC income.
>
> (a) an amount of income tax paid by the CFC from which the income is derived:
>
> (b) an amount of tax withheld and paid on behalf of the CFC from which the income is derived:
>
> (c) the amount of foreign income tax paid by the CFC from which the income is derived:
>
> (d) the amount of foreign income tax paid by the person in relation to the CFC from which the income is derived:

(e) the amount of foreign tax paid, under legislation of another country or territory that is equivalent of the international tax rules, by a foreign company in relation to income derived by the CFC.

105. Section LK 1(1) sets out the rules for claiming FTCs for foreign tax paid or payable by a CFC or a FIF (applying the AFIM), against a person's New Zealand tax liability on attributed FIF or CFC income. Subpart LK is designed to accommodate timing mismatches that can routinely occur between different jurisdictions. Consequently, a person in New Zealand can claim as a credit tax paid or payable in the US that relates to the CFC or FIF attributed income they derived, even if not paid in the relevant income year in New Zealand.

106. Section 93C of the Tax Administration Act 1994 assists if the amount of the credit cannot be determined before a return is filed. The Commissioner must amend an assessment on request to reflect a credit if the request is made within 4 years from the end of the relevant income year. It is not possible, however, to claim an FTC under s LK 1 if it relates to attributed income in a different income year. That is, FTCs can only be applied against the person's income tax liability for the same tax year. Any FTC claimed is limited to an amount that offsets the tax payable in New Zealand on the attributed FIF or CFC income derived as if it were stand-alone income in the relevant year. Any surplus is not refundable but may be carried forward to a subsequent income year under s LK 4 provided the loss carry forward requirements of s LK 5 are met.

107. In ordinary circumstances, the tax is paid by the CFC or FIF (that is, s LK 1(1)(c) applies). Section LK 1(1)(d) is an important exception, as it deals with the scenario where a CFC or a FIF does not itself pay the CFC's or FIF's foreign income tax, but another person does (for example, a New Zealand investor in the CFC or FIF that is a foreign hybrid entity). Section LK 1(1)(d) was introduced to enable a New Zealand investor in a CFC or a FIF (which is a hybrid company or partnership) to claim an FTC for any foreign income tax paid (for example, US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income) against their New Zealand tax liability on attributed CFC or FIF income.

108. The effect of s LK 1(1)(d) is that a New Zealand investor in a hybrid entity (for example, a US LLC) that is a CFC or a FIF (applying the AFIM) may claim an FTC for foreign tax that they pay in relation to that CFC or FIF. This is in the same way as a New Zealand investor in a foreign company that is not a hybrid entity and that is also a CFC or a FIF (applying the AFIM) may claim a tax credit for foreign tax that the CFC or FIF pays. The tax credit can be applied against attributed CFC or FIF income (under the AFIM) only.

How s CD 18 applies to investments in a US LLC

109. Section CD 18 is a special provision that addresses the possible over-taxation of foreign-sourced dividend income derived by a New Zealand investor from a foreign hybrid entity. This situation arises where a shareholder pays the foreign tax of the hybrid entity that, in ordinary circumstances, the hybrid entity would pay, and this reduces the amount available for distribution as a dividend by the entity. Section CD 18 is directed at hybrid entities such as a US LLC, which is a company for New Zealand tax purposes but taxed as a partnership for US tax purposes. Section CD 18 provides:

> **CD 18 Dividend reduced if foreign tax paid on company's income**
>
> *When this section applies*
>
> (1) This section applies when a person—
>
> (a) derives a dividend from a company that is a foreign company; and
>
> (b) has a liability under the laws of a country or territory outside New Zealand for income tax on income of the company corresponding to the liability that the person would have under the laws of New Zealand for income tax on income of the company if the company were a partnership in which the person were a partner; and
>
> (c) pays the income tax; and
>
> (d) provides to the Commissioner upon request, in the time allowed by the Commissioner, sufficient information to satisfy the Commissioner as to the amount of income tax paid.
>
> *When this section applies*
>
> (2) The amount of the dividend is reduced by the greater of zero and the amount calculated using the formula—
>
> total tax paid − earlier reductions
>
> *Definition of items in formula*
>
> (3) In the formula,—
>
> (a) **total tax paid** is the total amount of income tax on income of the company that the person has paid in the country or territory by the time that the person derives the dividend:
>
> (b) **earlier reductions** is the total amount of reductions under this section that, by the time that the person derives the dividend, have affected other dividends derived by the person from the company. [Original emphasis]

110. Section CD 18 works to eliminate the over-taxation of dividends derived by a New Zealand investor in a hybrid entity such as a US LLC, so that the New Zealand

investor is treated for New Zealand tax purposes as deriving the same amount of dividend income as a New Zealand investor in an ordinary (that is, non-hybrid) foreign company. This outcome is achieved by allowing a New Zealand investor in a foreign hybrid entity to reduce the amount of a dividend derived from the foreign hybrid entity by any foreign tax that the New Zealand investor pays (for example, as a "partner") on the foreign hybrid's income. Note that the provision only permits a reduction for tax actually paid by the time the dividend is derived. Unlike subpart LK, it does not extend to "tax paid or payable" to cover any timing mismatches between New Zealand and the foreign jurisdiction. Also, any refunds of foreign tax received must reduce the amount available as a reduction under s CD 18. A New Zealand investor in a US LLC may receive a refund as a result of filing their required personal tax return in the US. For an illustration of the treatment of a tax refund, see Example 2 (following [134]).

111. There is a requirement under the formula in s CD 18(2) to reconcile the foreign tax deducted from all dividends derived since inception of the investment in the company. This requirement ensures that only amounts of foreign tax the New Zealand investor has paid but has not already claimed as a reduction are available to reduce the dividends from the company that are taxed in New Zealand each year.

112. Example 1 illustrates clearly how s CD 18 applies.

Example | Tauira 1 – How s CD 18 applies to eliminate over-taxation of dividends

This example assumes the following:

- An individual New Zealand investor's interest in a US LLC cost less than $50,000 in a year and the investor does not hold any other interest in FIFs. (That is, the New Zealand investor is required to pay tax on only dividends derived from the FIF.)
- The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes is $1,000. The US LLC makes a $700 distribution in that year.
- The US imposes 30% ($300) federal income tax on the New Zealand investor's distributive share of the US LLC's income. The US LLC withholds the tax and pays it on behalf of the New Zealand investor.
- The US LLC made a distribution to the New Zealand investor in the prior year when the interest in the LLC was first acquired and US federal income tax was paid on that and then used to reduce the dividend derived in the prior year for New Zealand tax purposes.
- All amounts are expressed in New Zealand dollars.

New Zealand tax consequences

For New Zealand tax purposes, the $700 distribution and US withholding tax payment of $300 will both be a dividend. If the full $1,000 is taxed in New Zealand, there would be over-taxation of that dividend from the New Zealand investor's perspective compared with a dividend paid by an ordinary non-hybrid foreign company, because no recognition is given to the $300 US federal income tax the New Zealand investor paid.

In the case of an ordinary non-hybrid foreign company, the US company would pay the US tax of $300, and the dividend paid to the New Zealand investor would be $700 (after US company tax is paid). Section CD 18 achieves its objective by allowing the New Zealand investor to reduce the amount of the dividend that they derive from a foreign hybrid (the US LLC in this case) by the foreign tax that they pay on their distributive share of "partnership" income.

In this example, the New Zealand investor is taxed on $700 ($1,000 – $300), which is the same amount they would have been taxed on if the US LLC had been an ordinary US company and paid the $300 company tax on its own income, before distributing the remaining (after tax) amount of $700. The $300 reduction was made after taking into account the total US federal tax paid on the US LLC since the investment began under the formula in s CD 18(2) and the amount of that tax used to reduce the dividend derived in the prior year.

113. In the context of the Rulings, even though it uses a different mechanism than allowing FTCs, s CD 18 provides relief from the cross-jurisdictional taxation of dividends derived by New Zealand investors from a foreign hybrid entity. Section CD 18 reductions are available to investors in a US LLC that is a FIF or a CFC, except where the New Zealand investor is either:

113.1 taxed on FIF income calculated applying the FDR, CV, CM or DRR FIF income calculation methods, because the dividend is "exempt" in this case; or

113.2 a New Zealand company where the dividends derived from a foreign company are exempt income under s CW 9 (assuming the exclusions in s CW 9(2) or (3) do not apply).

How subpart OE (BETA) applies to individual investors in a US LLC

114. Section OE 1(2) provides that a natural person resident in New Zealand may choose to be a BETA person and maintain a BETA. These rules apply to an investment in a CFC and a FIF (where the New Zealand investor adopts the AFIM: s OE 5).

115. A BETA is available to an individual investor who has a net New Zealand tax liability (after FTCs have been applied) on their attributed CFC or FIF income. Its purpose is to enable such an investor to credit that amount to their BETA and to use this credit to satisfy any New Zealand tax liability payable on dividends derived from the FIF or CFC.

116. A BETA allows an individual investor to claim a tax credit (for tax that they pay on attributed CFC or FIF income) against their tax liability on dividend income, similar to the way an investor in a New Zealand resident company claims an imputation credit for underlying tax paid by the company. In both cases, the purpose of the credit is to avoid economic double taxation on the dividend derived by an individual investor.

117. A New Zealand resident company cannot maintain a BETA. However, as dividends it derives from a foreign company are exempt income under s CW 9 (assuming the exclusions in s CW 9(2) and (3) do not apply), economic double taxation does not arise.

118. The BETA tax credit is calculated by applying the formula set out in s OE 19. For example, a New Zealand investor may have attributed CFC or FIF income of $10,000 and foreign tax paid relating to that income of $3,000 (30%). Assume that the New Zealand investor's New Zealand tax liability is $3,300 (33%). The New Zealand investor can satisfy the New Zealand income tax liability by applying FTCs of $3,000 and paying the net tax liability of $300. The net tax paid of $300 can be credited to a person's BETA and applied against any subsequent New Zealand tax liability on any dividend derived from the CFC or FIF.

119. The New Zealand investor's right to use BETA tax credits to satisfy an income tax liability and the criteria that need to be satisfied for their use are set out in s OE 20.

How the NZ–US DTA applies to an investment in a US LLC

120. A double tax agreement can extend the circumstances where two countries agree to double taxation relief beyond their respective domestic tax laws. Two articles in the NZ–US DTA deal with relief from double taxation (arts 1(6) and 22) and may be relevant to the Rulings. Here we consider these articles in the context of whether they can provide any taxation relief beyond the applicable New Zealand domestic laws.

Article 22 of the NZ–US DTA provides relief where the same income is taxed to the same person in two tax jurisdictions

121. Article 22 of the NZ–US DTA provides (in part):

> In the case of New Zealand, double taxation shall be avoided as follows:

> In accordance with, and subject to any provisions of, the law of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax for tax paid in a country outside New Zealand (which shall not affect the general principle hereof), **United States tax paid under the law of the United States** and consistently with this Convention, whether directly or by deduction, **in respect of income derived by a resident of New Zealand arising in the United States** (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) **shall be allowed as a credit against New Zealand tax payable in respect of <u>that income</u>**; except that such credit shall not exceed the amount of the tax that would be paid to the United States if the resident were not a United States citizen or a United States company. However, where a company which is a resident of New Zealand beneficially owns at least 10 percent of the paid-up share capital of a United States company any dividend derived by the first-mentioned company from the United States company (being dividends which, in accordance with the taxation law of New Zealand in existence at the date of signature of the Convention would be exempt from New Zealand tax) shall be exempt from New Zealand tax.
>
> …
>
> For the purpose of allowing relief from double taxation pursuant to this Article, income shall be deemed to arise as follows:
>
> (a) income derived by a resident of the United States which may be taxed in New Zealand in accordance with this Convention shall be deemed to arise in New Zealand;
>
> (b) **income derived by a resident of New Zealand which may be taxed in the United States** in accordance with the Convention (other than income taxed by the United States solely because the beneficial owner is a citizen of the United States or a United States company) **shall be deemed to arise in the United States**;
>
> (c) For purposes of paragraph 3, income beneficially owned by a resident of New Zealand who is a citizen of the United States or a United States company shall be deemed to arise in New Zealand to the extent necessary to give effect to the provisions of this paragraph. [Emphasis added]

122. Article 22 applies to US tax paid on the same income derived by a New Zealand resident and arising in the US. That is, art 22 provides relief where the same income is taxed to the same person in two tax jurisdictions.

123. In the US LLC context, an amount allocated and credited to a member's capital account and distributed to a New Zealand investor is a dividend derived for New Zealand tax purposes and will "arise" in the US. However, in terms of the arrangements in the Rulings, no US tax is paid at source on this dividend distribution, so no FTC is claimable. The New Zealand investor has paid US federal income tax on their distributive share of the US LLC's US taxable income on a partnership basis, but that is

not US tax paid on the distribution to the New Zealand investor (which is a dividend for New Zealand tax purposes).

124. As such, art 22 does not operate to provide any taxation relief for dividend income derived from US LLCs.

Article 1(6) of the NZ–US DTA applies to a foreign investment by a New Zealand or US resident through a transparent entity

125. Article 1(6) of the NZ–US DTA deals with transparent entities, stating:

> An item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.

126. Article 1(6) applies to a foreign investment by a New Zealand or US resident through a transparent entity. Income derived through a transparent entity is taxed to a New Zealand or US resident only where that entity is treated as transparent for the purposes of New Zealand and US tax law respectively. For example, it applies for a New Zealand investor in a partnership established in the US that is also a partnership for New Zealand tax purposes. The US partnership is a partnership for New Zealand tax purposes and is transparent for New Zealand tax purposes: s HG 2. In these circumstances, the New Zealand partner is taxed directly on their share of the partnership income.

127. Article 1(6) does not apply to a New Zealand investor in a US LLC.[11] A New Zealand investor derives partnership income under US federal income tax law (which satisfies the first part of art 1(6)), but that partnership income is not treated for the purposes of the taxation law of New Zealand as the income, profit or gain of the New Zealand investor in the US LLC (so the second part of art 1(6) is not satisfied). This is because the US LLC is a company and not a transparent entity for New Zealand tax purposes.

128. Article 1(6) does not apply to the facts of the Rulings.

[11] This is confirmed in the US Department of the Treasury, *Department of the Treasury Technical Explanation of the Protocol Between the United States of America and New Zealand … signed at Wellington on July 23, 1982* (US Department of the Treasury, Washington, 2008), in an example at 4, last paragraph.

Overseas authority

129. The United Kingdom (UK) Supreme Court in *Anson v Commissioners for HMRC* [2015] UKSC 44 considered a dispute involving a UK investor in a Delaware LLC that was taxed as a partnership for US income tax purposes. Anson was resident but non-domiciled in the UK for UK tax purposes, meaning he was liable to UK income tax on foreign income remitted to the UK. The dispute revolved around whether Anson was entitled to an FTC for US tax he paid on his distributive share of the US LLC's income against UK tax paid on foreign remitted income from the US LLC.

130. The UK Supreme Court had to consider whether the income on which Anson paid tax in the US was the "same" as the income on which he was liable to tax in the UK for the purposes of art 23(2)(a) of the UK–US Double Tax Agreement. The UK Supreme Court considered that answering that question depended on analysing the legal regime governing the respective rights of the entity and its members in relation to the profit.

131. Based on the First-tier Tribunal's findings of fact that Anson was entitled to the share of the profits allocated to him by the US LLC as they arose, the UK Supreme Court held that it followed that Anson's "income arising" in the US was his share of the profits, and this was therefore the income liable to tax under UK law to the extent it was remitted to the UK. Therefore, Anson qualified for double tax relief under art 23(2)(a) of the UK–US Double Tax Agreement as his liability to tax in the UK was computed by reference to the "same" income as was taxed in the US.

132. The Commissioner does not consider that the decision of the UK Supreme Court in *Anson* affects the analysis set out in this commentary. To determine how profit or income is to be taxed in New Zealand, the New Zealand legislative scheme requires an entity to be classified for New Zealand tax purposes. Based on the characteristics of a US LLC under US law, the Commissioner considers that a US LLC is a company because the legal characteristics of the US LLC meet the New Zealand tax definition of "company"[12]. Accordingly, the New Zealand legislative scheme treats the US LLC as deriving the income from the conduct of its business (that is, the income is treated as derived by the US LLC, rather than by the members of the US LLC). Consequently, a New Zealand investor in a US LLC will be subject to New Zealand tax on distributions or dividends they derived from the US LLC and/or any FIF income or attributed CFC income, where the US LLC is a FIF or a CFC.

133. Section CD 18 is also an important feature of the scheme of the Act dealing with foreign hybrid entities. It deals explicitly with company–partnership foreign hybrids (US LLCs in this context) and the over-taxation of foreign source dividend income derived from a foreign hybrid entity. Section CD 18 permits a New Zealand investor in

[12] In New Zealand, entities and transactions are characterised according to their legal form and not what transaction or entities they most closely resemble: *Mills v Dowdall* [1983] NZLR 154 (CA) at 159.

a foreign hybrid entity to reduce the amount of the dividend they derive from the foreign company by the foreign tax that they have paid. Section CD 18 is premised on the foreign hybrid entity (US LLC in this context) being a company that derives its own income and pays a dividend to its shareholder (even though it is taxed as a partnership in the foreign tax jurisdiction).

Examples

134. The six examples that follow have these common features:

134.1 A New Zealand investor (natural person or company) invests in a US LLC and is not the sole shareholder.

134.2 The US LLC is a company for New Zealand tax purposes.

134.3 The US LLC owns the assets of the business, and the business is conducted by the US LLC rather than by its members.

134.4 The US LLC is treated as a partnership in the US, has not made an election to be taxed as a corporation in the US and the New Zealand investor is subject to US federal income tax on their distributive share of the US LLC's income.

134.5 The New Zealand investor's US federal income tax liability is withheld by the US LLC and paid on behalf of the New Zealand investor.

134.6 The New Zealand investor is required to and does file a US tax return, including their distributive share of the US LLC income and tax withheld on their behalf by the US LLC.

134.7 The payment of US federal income tax by the US LLC withheld on behalf of a New Zealand investor is treated in the US LLC's accounts as a distribution to the investor (that is, as a debit to the member's capital account).

134.8 The US LLC's payment of the member's US federal income tax on their behalf is a distribution and a dividend for New Zealand tax purposes.

134.9 The Managing Members of the US LLC have the power to make distributions in their sole discretion. (Note that this feature does not apply to Example 2.)

134.10 No US tax is paid on distributions from the US LLC, which are dividends for New Zealand tax purposes.

134.11 The US federal income tax rate is assumed to be 30%.

134.12 Where the New Zealand investor is a natural person, it is assumed they have a marginal tax rate of 33%, are not a transitional resident, and have not opted

into the FIF rules where the total cost of all FIF interests they hold are $50,000 or less.

134.13 All amounts are expressed in New Zealand dollars.

Example | Tauira 2 – Individual New Zealand investor's investment in a US LLC is under the $50,000 FIF threshold and distributions to members are mandatory

Circumstances

An individual New Zealand investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of the individual investor's attributing interest in FIFs does not exceed $50,000 throughout the year.

The New Zealand investor can withdraw amounts from their capital account, representing their share of the US LLC's annual net accounting profits on request, subject to cash being available.

The New Zealand investor's share of the US LLC's net accounting profit is $1,100, as determined by the US LLC's operating agreement. This share is credited to the New Zealand investor's capital account in year 1. The New Zealand investor can withdraw this amount from their capital account as they wish.

The New Zealand investor's distributive share of the US LLC's income for US federal income tax purposes is $1,000, and the US federal income tax liability on that income is $300 (30%). The distributive share is the New Zealand investor's proportional share of net accounting profits adjusted as required to meet US tax requirements.

The New Zealand investor's US federal tax liability is withheld by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account) in year 1.

The US LLC subsequently distributes $700 to the New Zealand investor in year 2. The New Zealand investor also receives a US tax refund of $50 in year 2 after filing their US tax return for year 1.

Years 1 and 2 correspond to two different New Zealand income tax years – New Zealand income tax years 1 and 2.

New Zealand tax consequences

The New Zealand investor will be taxed on the $1,100 dividend (the amount credited to their capital account and able to be withdrawn by the New Zealand investor) derived from the US LLC, allocated to the income year their capital account is credited. The investor does not have FIF income due to s CQ 5(1)(d). The New Zealand investor will be subject to tax on this dividend in New Zealand in income tax year 1, which is the

New Zealand tax consequences

The New Zealand investor will be taxed on only the actual dividends (the $700 distribution and $300 US federal income that the US LLC paid on behalf of the New Zealand investor) derived from the US LLC under s CD 1. The investor does not have FIF income due to s CQ 5(1)(d).

Section CD 18 applies to reduce the amount of the dividend by the US federal income tax paid by the New Zealand investor ($300). In other words, the New Zealand investor's dividend income is $1,000 (the dividend) less $300 (the US tax paid by the New Zealand investor). The New Zealand investor pays New Zealand income tax (at 33%) on the reduced dividend of $700 ($231).

The New Zealand investor cannot claim a New Zealand FTC (under subpart LJ or the New Zealand–US DTA) for US federal income tax paid on the distributive share against their New Zealand tax liability on the $1,000 distribution treated as dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's US LLC distributive share is not paid on the dividend distribution from the US LLC and so is not tax paid on the relevant segment of foreign-sourced income.

Example | Tauira 4: Individual New Zealand investor in a US LLC adopts one of four FIF income calculation methods

Circumstances

A New Zealand individual investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of their interest is $60,000.

The New Zealand investor can adopt and chooses to adopt one of the four FIF income calculation methods: FDR, CV, CM or DRR.

The New Zealand investor's FIF income from the US LLC adopting FDR is $2,000.

The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes is $2,800, and the US federal income tax liability on that income is $840 (30%).

The New Zealand investor's US federal tax liability is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

The US LLC subsequently distributes $1,900 to the New Zealand investor.

New Zealand tax consequences

The New Zealand investor will be taxed on their FIF income as calculated by applying one of the four FIF income calculation methods. In this example, the FIF (FDR) income is $2,000 and New Zealand tax (at 33%) is $660.

The total distribution of $2,740 (the $1,900 distribution and the $840 US federal income tax paid by the US LLC on behalf of the New Zealand investor) paid to the New Zealand investor by the US LLC is excluded income under ss EX 59(2) and CX 57B. Section CD 36 also explicitly excludes it from being a dividend for New Zealand tax purposes. Under s CD 36, a distribution is not a dividend where a person adopts one of the four methods (FDR, CV, CM or DRR) of calculating FIF income.

Section CD 18, which provides relief from the over-taxation of dividend distributions from foreign hybrid entities, does not apply because the distribution is not a dividend under s CD 36.

A New Zealand investor cannot claim a New Zealand FTC (under subpart LJ or the NZ–US DTA) for US federal income tax on their distributive share against their New Zealand tax liability on FIF income. This is because the US federal income tax paid on the New Zealand investor's distributive share is not foreign tax paid on FIF income and so is not tax paid on the relevant segment of foreign-sourced income.

A New Zealand investor who chooses to adopt CV for their FIF income will treat the payment of the $840 of US tax on its behalf as a cost, a gain, and a reduction of the closing value under the formula in s EX 51(1) when calculating their FIF income.

Example | Tauira 5: New Zealand investor adopts the AFIM for calculating FIF income

Circumstances

A New Zealand investor (a company or individual) invests in a US LLC that is a FIF for New Zealand tax purposes. The New Zealand investor can adopt and chooses to adopt the AFIM for calculating FIF income, and the exemption for a non-attributing active FIF in s CQ 5(1)(c)(xv) does not apply.

The New Zealand investor's FIF attributed income is $2,000 in their first year of holding the US LLC.

The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes is $2,100. The US federal income tax liability on that income in the first year is $630 (30%).

The New Zealand investor's US federal tax liability ($630) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

The US LLC subsequently distributes $1,400 to the New Zealand investor.

New Zealand tax consequences

The New Zealand investor is subject to New Zealand income tax on FIF income and (if they are an individual) on any dividends they derived from the US LLC.

The New Zealand investor is taxed on their share of the FIF's income ($2,000), and New Zealand tax is $660 (33% if an individual) or $560 (28% if a company) under ss CQ 4, CQ 5, CQ 6, EX 44(1)(b) and EX 50.

The US federal income tax the New Zealand investor paid ($630) on their share of the US LLC's income is creditable against their FIF attributed income tax liability: s LK 1(1)(d).

Note that this tax credit only applies to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and it only relates to foreign tax paid in relation to income that is attributed FIF income. The individual New Zealand investor's net New Zealand tax liability is $660 less $630 (the FTC for US tax paid on their distributive share of the US LLC's profit), which equals $30 net New Zealand tax payable. For a company investor, no further New Zealand tax is payable as the FTC exceeds the New Zealand tax amount ($560 – $630).

The total distribution of $2,030 (the $1,400 distribution and the $630 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend and so it is income under s CD 1 for New Zealand tax purposes.

The New Zealand tax consequences of the dividend distribution are as follows:

- Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income under s CW 9 (provided the exclusions in s CW 9(2) and (3) do not apply). No FTCs are claimable.
- If the New Zealand investor is an individual, they may reduce the amount of the dividend they derived from the US LLC ($2,030) by the US federal income tax paid on their share of the US LLC's income ($630): s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend (that is, net of foreign tax they paid in the US, which is $1,400).
- An individual New Zealand investor may choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on

their attributed FIF income (after claiming an FTC), then the individual investor may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

- The individual New Zealand investor's net New Zealand tax liability after FTCs is $30 (the FIF income tax liability of $660 ($2,000 FIF income × 33% tax rate) less FTC $630 = $30). The investor may use the $30 as a BETA tax credit to satisfy any New Zealand tax liability on dividends they derived from the FIF.

Example | Tauira 6: Investment in a US LLC that is a CFC

Circumstances

A New Zealand investor (company or individual) has an income interest of 10% in a US LLC that is a CFC. The CFC is not a non-attributing active CFC under ss CQ 2(1)(h) and EX 21B.

The New Zealand investor's CFC income is $2,000 in the first year of their investment.

The New Zealand investor's distributive share of the US LLC's income in that same year is $1,900. The US federal income tax liability on that income is $570 (30%).

The New Zealand investor's US federal tax liability ($570) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

The US LLC subsequently distributes $1,300 to the New Zealand investor.

New Zealand tax consequences

The New Zealand investor is subject to New Zealand income tax on CFC income and any dividends derived from the US LLC.

The New Zealand investor is taxed on their share of the CFC's income, that is $2,000. New Zealand tax for the individual (at 33%) is $660 and for the company (at 28%) is $560 under ss CQ 1 and CQ 2.

The US federal income tax the New Zealand investor paid ($570) on their share of the US LLC's income in the same year they acquired the investment is creditable against the New Zealand investor's CFC attributed income tax liability: s LK 1(1)(d). Note that this tax credit only applies to the extent it does not exceed the New Zealand tax

payable on the CFC attributed income and it only relates to foreign tax paid in relation to income that is attributed CFC income.

The individual New Zealand investor's net New Zealand tax liability is $660 less $570 (the FTC for US tax paid on their share of the US LLC's profit), which equals $90 net New Zealand tax payable. Where the New Zealand investor is a company, there is no further New Zealand tax liability as the FTC of $570 exceeds the New Zealand tax liability of $560.

The total distribution of $1,870 (the $1,300 distribution and the $570 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend and so it is income under s CD 1 for New Zealand tax purposes.

The New Zealand tax consequences of the dividend distribution are as follows:

- Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income under s CW 9 (provided the exclusions in s CW 9(2) and (3) do not apply). No FTCs are claimable.
- If the New Zealand investor is an individual, they may reduce the amount of the dividend they derived from the US LLC ($1,870) by the US federal income tax paid on their distributive share of the US LLC's income ($570): s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend (that is, net of foreign tax they paid in the US, which is $1,300).
- An individual New Zealand investor can choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming FTC), then they may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed CFC income) against the New Zealand tax liability on the reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.
- The individual New Zealand investor's net New Zealand tax liability after FTCs is $90 (the FIF income tax liability of $660 ($2,000 FIF income × 33% tax rate) – FTC $570 = $90). The investor may use the $90 as a BETA tax credit to satisfy any New Zealand tax liability on dividends they derived from the CFC.

Example | Tauira 7: Investment in a US LLC that is a non-attributing active FIF or a non-attributing active CFC

Circumstances

A New Zealand investor (company or individual) invests in a US LLC that is a non-attributing active FIF or CFC.

The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes in their first year of investment is $1,000, and the US federal income tax liability on that income is $300 (30%).

The New Zealand investor's US federal tax liability ($300) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

The US LLC subsequently distributes $700 to the New Zealand investor.

New Zealand tax consequences

There is no attributed income for either CFC or FIF purposes under s CQ 2(1), due to s CQ 2(1)(h), or under s CQ 5(1), due to s CQ 5(1)(c)(xv).

The total distribution of $1,000 (the $700 distribution and the $300 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend and so it is income under s CD 1 for New Zealand tax purposes.

The New Zealand tax consequences of the dividend distribution are as follows:

- Where the investor is a company, any dividends derived by a company from a foreign company are exempt income under s CW 9 (provided the exclusions in s CW 9(2) and (3) do not apply). No FTCs are claimable.
- If the investor is an individual, they may reduce the amount of the dividend they derived from the US LLC ($1,000) by the US federal income tax paid on their share of the US LLC's income ($300): s CD 18. The individual New Zealand investor is subject to New Zealand tax on the reduced dividend (that is, net of foreign tax they paid in the US, which is $700).
- An individual New Zealand investor can choose to be a BETA person under s OE 1(2). However, as there is no FIF or CFC attributed income for the income year, no BETA credit is available for that year.

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered

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ss BD 3, CB 1, CD 1, CD 3, CD 4 to CD 6, CD 18, CD 36, CQ 1, CQ 2, CQ 4, CQ 5, CQ 6, CW 9, CX 57B, EX 1, EX 14 to EX 17, EX 21B, EX 28 to EX 44, EX 46, EX 50, EX 51, EX 59, HG 2, LJ 1, LJ 2, LJ 4, LK 1, LK 4, LK 5, subpart OE, YA 1 ("company", "foreign company", "partnership", "share")

Other

2014 Delaware Code: § 18-503

Double Taxation Relief (United States of America) Order 1983: arts 1, 22

Internal Revenue Code (US): §§ 701, 703

Limited Liability Company Act (Delaware): §§ 18-201, 18-502, 18-701

Partnership Law Act 2019: s 8

Tax Administration Act 1994: s 93C

Case references | Tohutoro kēhi

Alliance Group Ltd v CIR [1995] 17 NZTC 12,066 (HC)

Anson v Commissioners for HMRC [2015] UKSC 44

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Other references | Tohutoro anō

IRS, *Taxation of Limited Liability Companies* (Publication 3402, Internal Revenue Service, Washington, 2016)

US Department of the Treasury, *Department of the Treasury Technical Explanation of the Protocol Between the United States of America and New Zealand … signed at Wellington on 23 July 1982* (US Department of the Treasury, Washington, 2008)

S Watson and L Taylor (eds), *Corporate Law in New Zealand* (online ed, Thomson Reuters, 2019)

Appendix | Āpititanga

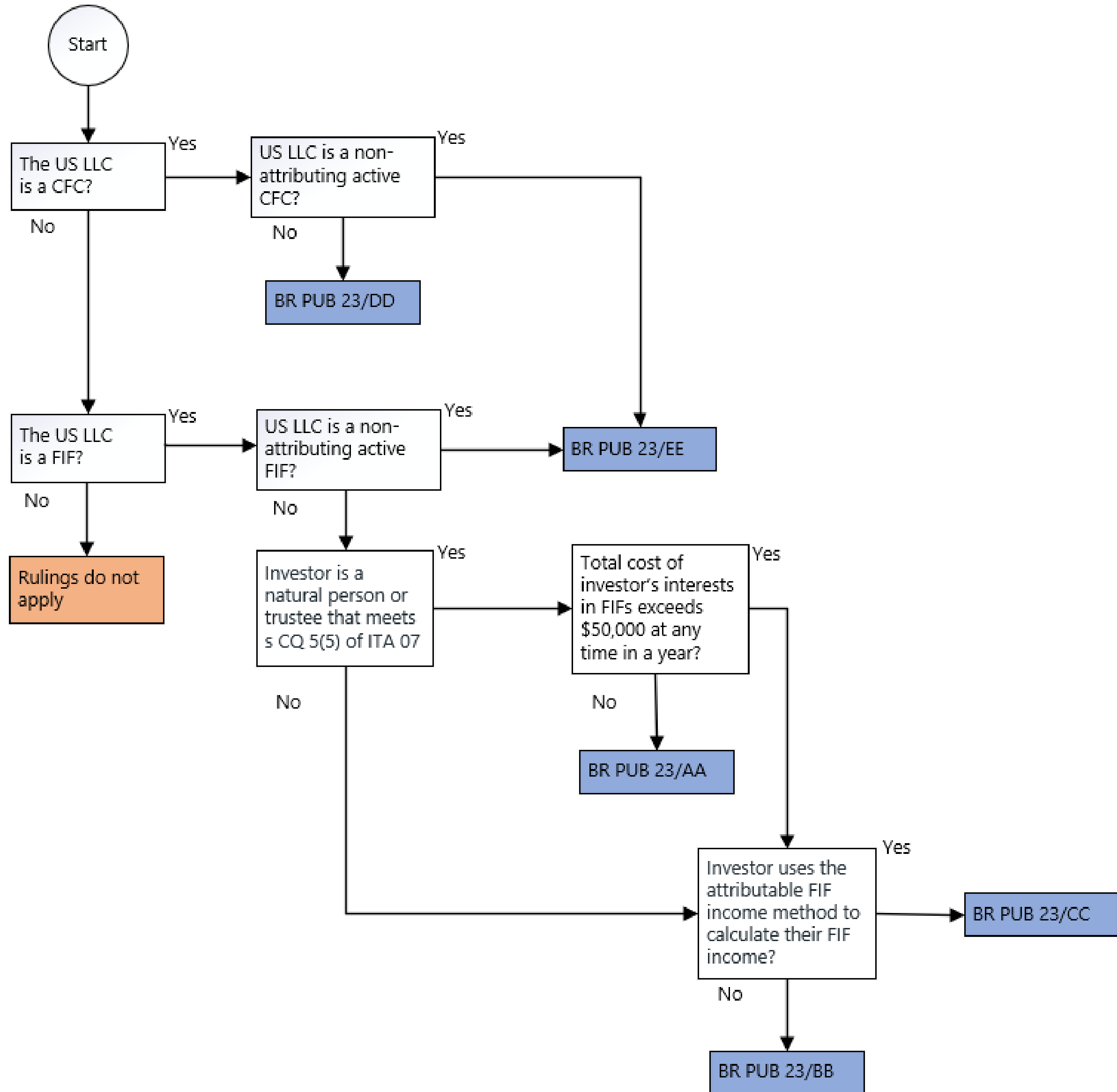
The flowchart and tables in this Appendix are intended to be an indicative tool only to be read in conjunction with the features of the arrangements as outlined in the Rulings.

Only the Public Rulings BR Pub 23/AA – 23/EE should be relied on as reflecting the Commissioner's view on how the taxation laws apply.

Abbreviations

AFIM	attributable FIF income method
BETA	branch equivalent tax account
CFC	controlled foreign company
FIF	foreign investment fund
FTC	foreign tax credit
ITA 07	Income Tax Act 2007
N/A	not applicable
NZ	New Zealand
US LLC	United States limited liability company

Which Ruling may apply to my situation?



Tax treatment of income derived by a New Zealand investor from a US LLC

Jurisdiction	United States	New Zealand	
	US LLC NZ Member	NZ Shareholder	
Income tax treatment of US LLC	**Partnership if more than one member unless elects to be a corporation**	**Foreign company**	
Taxation of income derived by investor	**Distributive share** US LLC withholds US federal income tax from NZ member's distributive share of US LLC's income.	**FIF/CFC income** Investors pay income tax on FIF or CFC income derived from US LLC in certain circumstances.	**Distributions** Investors other than companies pay income tax on distributions from US LLC that are dividends in certain circumstances.
Double taxation relief available in New Zealand		Foreign tax credit for US federal income tax paid available for FIF-AFIM and attributing CFCs. Relief for US federal income tax paid available when comparative value method used for FIF income.	Dividend reduction under s CD 18 for US tax paid where dividend taxable. BETA credit available for investors other than companies who derive FIF-AFIM or CFC attributed income.

FIF table

US LLC is a FIF: Tax treatment of income amounts and double taxation relief for income derived by NZ investor			Non-attributing active FIF	FIF income - AFIM method	FIF income - other methods	No FIF income - Total FIF interests < $50K
Natural persons and trustees that meet s CQ 5(5) requirements	**Share of LLC profits**	**FIF income?**	N	Y	Y	N/A
		FTC?	N	Y – capped at NZ tax	N	N/A
	Distribution	**Income tax treatment**	Taxable dividend	Taxable dividend	Not a dividend and excluded income	Taxable dividend
		CD 18 dividend reduction?	Y	Y	N	Y
		BETA?	N/A	Y	N	N/A
Persons other than companies	**Share of LLC profits**	**FIF income?**	N	Y	Y	N/A
		FTC?	N	Y - capped at NZ tax	N	N/A
	Distribution	**Income tax treatment**	Taxable dividend	Taxable dividend	Not a dividend and excluded income	N/A
		CD 18 dividend reduction?	Y	Y	N	N/A
		BETA?	N/A	Y	N	N/A
Companies	**Share of LLC profits**	**FIF income?**	N	Y	Y	N/A
		FTC?	N	Y - capped at NZ tax	N	N/A
	Distribution	**Income tax treatment**	Exempt dividend	Exempt dividend	Not a dividend and excluded income	N/A
		CD 18 dividend reduction?	N/A	N/A	N/A	N/A
		BETA?	N/A	N/A	N/A	N/A

CFC table

US LLC is a CFC: Tax treatment of income amounts and double taxation relief for income derived by NZ investor			**Non-attributing active CFC**	**Attributing CFC**
Persons other than companies	**Share of LLC profits**	**CFC income?**	N	Y
		FTC?	N	Y – capped at NZ tax
	Distribution	**Income tax treatment**	Taxable dividend	Taxable dividend
		CD 18 dividend reduction?	Y	Y
		BETA?	N/A	Y
Company	**Share of LLC profits**	**CFC income?**	N	Y
		FTC?	N	Y – capped at NZ tax
	Distribution	**Income tax treatment**	Exempt income	Exempt income
		CD 18 dividend reduction?	N/A	N/A
		BETA?	N/A	N/A

About this document | Mō tēnei tuhinga

Public Rulings are issued by the Tax Counsel Office. Public Rulings set out the Commissioner's view on how tax laws apply to a specific set of facts – called an arrangement. Taxpayers whose circumstances match the arrangement described in a Public Ruling may apply the ruling but are not obliged to do so. Public Rulings are binding on the Commissioner. This means that if you are entitled to apply a Public Ruling and you have calculated your tax liability in accordance with the ruling, the Commissioner must accept that assessment. A Public Ruling applies only to the taxation laws and arrangement set out in the ruling, and only for the period specified in the ruling. It is important to note that a general similarity between a taxpayer's circumstances and the arrangement covered by a Public Ruling will not necessarily lead to the same tax result.