

Interpretation Statement IS 16/05 – Fact Sheet

How to claim a foreign tax credit where the foreign tax paid is covered by a Double Tax Agreement

The purpose of this Fact Sheet is to give a broad overview of IS 16/05. It is a guide only. Taxpayers should refer to IS 16/05 for specific details on how to claim a foreign tax credit where the foreign tax paid is covered by a Double Tax Agreement.

What is a Double Tax Agreement?

New Zealand taxes its residents on their worldwide income, as do most other countries. This means that if you are a New Zealand tax resident and you earn income from overseas, that income will likely be taxable in New Zealand. However, it is likely that the overseas country will also want to tax that income. This means you might pay tax twice on the same income – once in the overseas country and then again in New Zealand. To reduce the occasions where this happens, New Zealand enters into Double Tax Agreements (DTAs) with overseas countries. DTAs contain rules agreed between New Zealand and the overseas country that try to eliminate double taxation for residents of both countries.

How does a Double Tax Agreement work?

Sometimes a DTA will prevent an overseas country from taxing the income so it is taxed only in New Zealand. Sometimes a DTA will prevent New Zealand from taxing the income so it is taxed only overseas. However, it is most likely that New Zealand and the overseas country will agree to share the right to tax the income. For New Zealand tax residents, this means the overseas country will be allowed to tax the income (or to tax the income at a reduced rate) and New Zealand will agree to give a foreign tax credit for the tax paid overseas.

What does Interpretation Statement IS 16/05 explain?

Interpretation Statement IS 16/05 explains how to claim a foreign tax credit when a DTA applies. A foreign tax credit can be offset against your New Zealand income tax liability.

Who does Interpretation Statement IS 16/05 apply to?

Interpretation Statement IS 16/05 applies to New Zealand tax residents who:

- have derived income from overseas;
- have paid foreign tax on that income; and
- are taxable on that income in New Zealand.

Where a DTA covers the foreign tax paid, the DTA will determine how the double tax is relieved.

How do I find out whether New Zealand has a DTA with an overseas country?

Inland Revenue's website lists the countries that New Zealand has entered into DTAs with:

www.ird.govt.nz/international/residency/dta

Inland Revenue's tax policy website has more detailed information, including actual DTAs: www.taxpolicy.ird.govt.nz/tax-treaties

Is the tax I paid overseas covered by a Double Tax Agreement?

To find out if a DTA covers tax you paid overseas, you need to read the DTA relevant to the specific country. The taxes covered by a DTA are usually listed in article 2 of

the DTA. However, a tax may still be covered by a DTA even if it is not listed in article 2 (see from [77] of the Interpretation Statement).

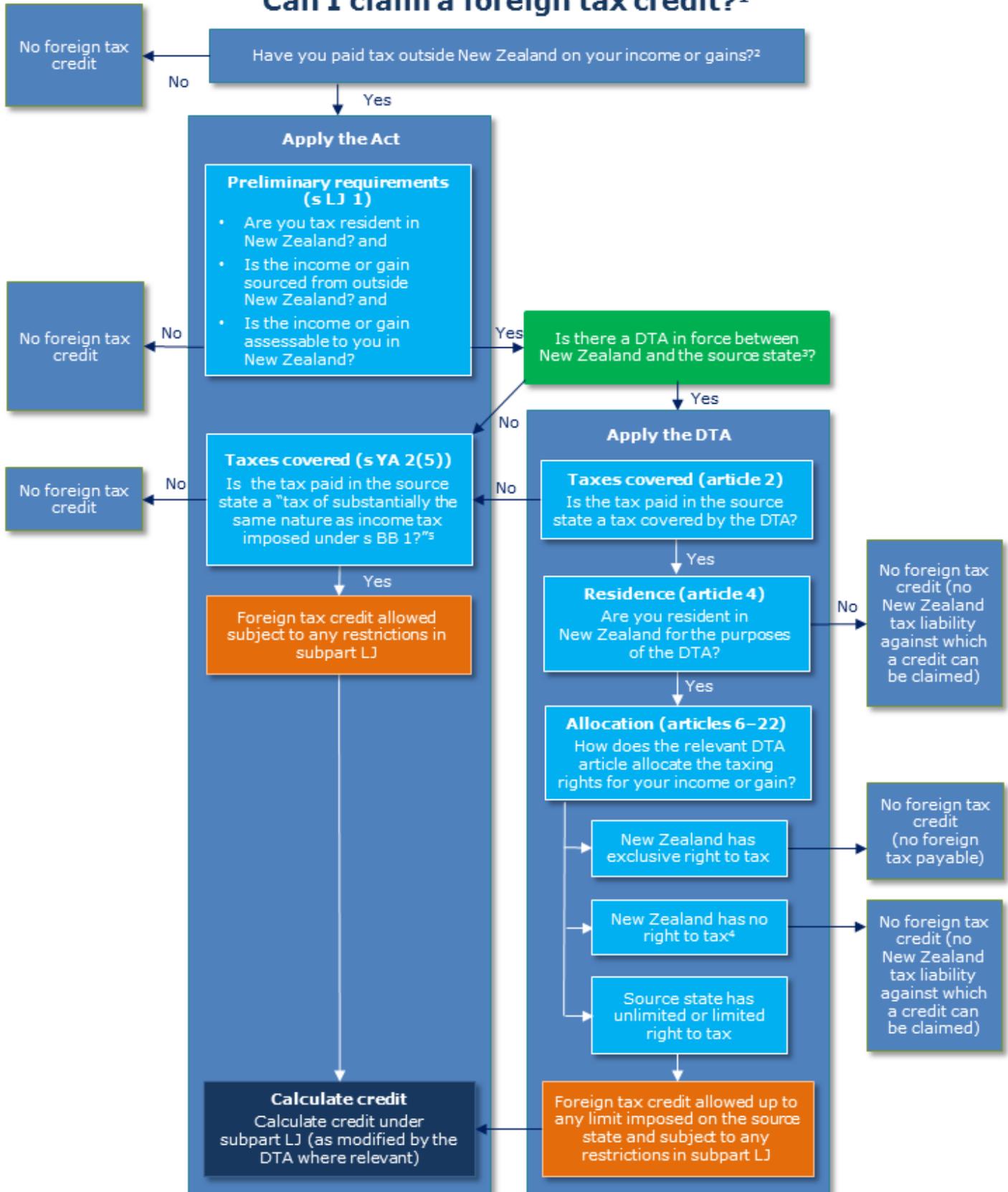
What if the foreign tax I paid is not covered by a Double Tax Agreement?

If there is no DTA or if the foreign tax is not covered by the relevant DTA, you may still be entitled to a foreign tax credit under New Zealand's domestic law foreign tax credit rules. For guidance, see "Interpretation Statement IS 14/02: Income tax – foreign tax credits – what is a tax of substantially the same nature as income tax imposed under s BB 1?", *Tax Information Bulletin* Vol 26, No 5 (June 2014): 3.

How easy is it to work out if I can claim a foreign tax credit?

The flowchart below simplifies the process for claiming a foreign tax credit. You will need to read the Interpretation Statement and the relevant DTA to get the correct answer.

Can I claim a foreign tax credit?¹



¹ All legislative references are to the Income Tax Act 2007.

² Different rules exist if a tax-sparing article applies.

³ "Source state" refers to a country or a territory.

⁴ This only occurs when article 20 (students) applies.

⁵ See IS 14/02: "What is a tax of substantially the same nature as income tax imposed under s BB 1?" cited above.