Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT: IS 20/06

Income tax – Tax issues arising from ownership of foreign residential rental property

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

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Summary

1. If you are a New Zealand tax resident who owns a foreign residential rental property, you need to be aware of the New Zealand tax issues that may arise as a result of that ownership. As a New Zealand tax resident, you may be required to pay tax in New Zealand on any income you receive from your foreign residential rental property. You may also be required to pay tax on the same income in the country where the property is located.

2. Importantly, the way you calculate the rental income from your foreign residential property for New Zealand tax purposes may be different from the way you calculate it for foreign tax purposes. For example, the deductions you are entitled to claim, and the balance dates used may differ. You will also need to make sure you convert the foreign currency amounts into New Zealand dollars using the correct rates for the correct dates.

3. In addition to paying New Zealand tax on rental income from your foreign residential property, you may also be required to pay New Zealand tax on any gains you make if you sell the property. This is because New Zealand's land taxing rules can apply to foreign property owned by New Zealand tax residents in the same way they do for New Zealand property.

4. If you are required to pay tax on income from your foreign residential rental property both in New Zealand and overseas, you may be entitled to claim foreign tax credits in New Zealand for tax paid overseas.

5. If you have taken out a foreign currency loan to finance your foreign residential rental property, you may also need to apply the financial arrangements rules (FA rules) to that loan. Under the FA rules, the movement of foreign exchange rates will affect the amount of deemed interest expenditure able to be claimed, and can in some cases result in an amount of deemed income. Having a foreign currency loan from a non-resident lender, such as a foreign bank, may also mean you need to withhold non-resident withholding tax (NRWT) on the interest you pay on that loan, and pay that NRWT to Inland Revenue.

6. Because these issues can be complicated and the outcomes can vary depending on a person's circumstances, you may wish to seek professional tax advice tailored to your situation.

Introduction

7. This Interpretation Statement provides general guidance on the New Zealand tax issues that may arise if you are a New Zealand tax resident individual who owns foreign residential rental property.

8. This Interpretation Statement does not discuss situations involving foreign property that are:

   (a) exclusively used for private purposes; or

   (b) owned by non-residents, partnerships, trusts, or entities such as companies.

9. Although the guidance in this Interpretation Statement is for individuals, the way in which rental income and expenses are calculated for income tax purposes is generally the same for all taxpayers.

New Zealand tax residents taxed on worldwide income

10. Generally, New Zealand tax residents are taxed on their worldwide income, not just income that has a New Zealand source. This means that even though you may have returned income from your foreign rental property in the country where it is located, in most cases you will also need to return the income from that property for New Zealand tax purposes. This is the case even if you have not repatriated the income.

Tax rules vary from country to country

11. If you do need to return income from your foreign rental property for New Zealand tax purposes, it is unlikely that you will be able to simply copy the income and expense amounts you calculated for foreign tax purposes straight into your New Zealand tax return. This is because, to a greater or lesser degree, tax rules vary from country to country. For example:

    (a) the deductions you may be entitled to claim for New Zealand tax purposes may differ from those permitted overseas and vice versa;

    (b) the way gains from the sale of land are taxed in New Zealand may not be the same overseas;

    (c) the applicable balance dates for a taxation income year and when income or expenses are recognised as derived or incurred vary from country to country;

    (d) New Zealand's tax rules require you to convert foreign currency amounts into New Zealand dollars using particular methods; and

    (e) the application of New Zealand's FA rules can alter the amount of interest you can deduct in New Zealand on a foreign currency loan. In some cases, the FA rules can even give rise to an amount of deemed income attributable to foreign exchange gains made on a foreign currency loan.

12. In addition to the examples listed above, other complexities arise relating to the availability of foreign tax credits where tax has been paid on income in a foreign country and tax is also payable on the same income in New Zealand.

13. Other New Zealand tax obligations may also arise if you own a foreign property, including:

    (a) compliance with the provisional tax rules (if applicable), which require tax payments to be made throughout the tax year rather than just at the end; and

    (b) withholding of NRWT or the payment of an approved issuer levy (AIL) when you pay interest on a loan to a non-resident lender.

Tax residency

Residents other than transitional residents

14. The starting point for determining whether you have any New Zealand tax obligations on your foreign property is to check whether you are a New Zealand tax resident. If you are not a tax resident of New Zealand, it is unlikely that income arising from a foreign rental property would be taxable in New Zealand.

15. The rules that determine when you will be a New Zealand tax resident are covered in Interpretation Statement "IS 16/03: Tax residence", *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2. These rules differ from those used for immigration purposes. Essentially, a natural person will be a New Zealand tax resident if they:

    (a) are present in New Zealand for more than 183 days in a 12-month period; or

    (b) have a permanent place of abode (essentially, a home) in New Zealand.

16. It is possible for a person to be resident of two (or more) countries or territories according to each country's or territory's laws. However, if a double tax agreement (DTA) exists between New Zealand and the other country or territory, the articles of the DTA will determine the taxing rights of each country or territory, and in which country or territory the person will be regarded as being tax resident for the purposes of the DTA. Where both countries or territories are entitled to tax a person's income, the DTA will generally make provision for relieving the resulting double taxation. If no DTA exists between New Zealand and the foreign country or territory, then the person will remain a tax resident in both countries or territories. This likely means the foreign rental income will be taxed in both New Zealand and the foreign country or territory. If double taxation occurs, the taxpayer must rely on foreign tax credits for the foreign tax paid being available under New Zealand tax law. Tax credits for tax paid in DTA and non-DTA countries and territories are discussed later in this item at [58] to [76].

17. If a person is not a tax resident of New Zealand, they are liable for New Zealand tax on only their New Zealand–sourced income.

Transitional residents

18. Although New Zealand tax residents are generally taxed on their worldwide income, there is a special class of New Zealand tax residents called "transitional residents". Transitional residents are eligible for an exemption on most types of foreign-sourced income during their transitional residency period.

19. To qualify as a transitional resident (s HR 8), a person must:

    (a) be a New Zealand tax resident;

    (b) have not been a New Zealand tax resident in the preceding 10 years before they became a New Zealand tax resident; and

    (c) have not been a transitional resident before.

20. The transitional residency period generally lasts four years, but can be up to five years, depending how a person qualifies as a New Zealand tax resident. In some circumstances, a person's transitional residency period may end early; for example, if they or their spouse, civil union partner, or de facto partner apply for family tax credits. During the transitional residency period, transitional residents are exempt from tax on all foreign-sourced income (s CW 27) except for:

    (a) employment income in connection with employment or services performed while the person is a transitional resident; and

    (b) income from a supply of services.

21. Therefore, if you are a transitional resident, you will not be taxed on any income received from a foreign rental property during the transitional residency period. However, because this income is not taxed in New Zealand, you are not permitted

to claim any deductions for expenses incurred in deriving that income (s DA 2(3)). You may still be subject to taxation in the country where the property is located.

22. In addition to not being required to pay tax on most types of foreign-source income, transitional residents are not required to withhold NRWT (or pay AIL) on interest paid to a non-resident lender during the transitional residency period, as long as the loan was entered into before they became a transitional resident (s RF 12). However, a transitional resident must withhold NRWT if the loan is entered into during the transitional residency period.

23. For the remainder of this item, it is assumed you are not a transitional resident, unless otherwise stated (see [39], [41], [47], [64], [83] and also examples 1 and 2).

New Zealand tax rules apply

General – different countries have different tax rules

24. As noted at [10] and [16], if you own a foreign rental property you are likely to be taxed on your rental income from that property in the country where it is located. To calculate what tax is payable on your rental income in the foreign country, you would usually prepare tax accounts applying the foreign country's tax rules. It is important to note that the amount of taxable income calculated in your foreign tax accounts cannot simply be entered as the taxable income amount in your corresponding New Zealand tax return.

25. Because every country's tax rules are different, foreign tax calculations will typically be inappropriate for New Zealand tax purposes. Some of the general ways in which foreign tax accounts may differ from tax accounts prepared for New Zealand tax purposes include:

    (a) the basis for determining when income is "derived" (cash basis or accrual basis);

    (b) the applicable balance dates used overseas and in New Zealand; and

    (c) the methods and rates used to convert amounts of foreign income and expenses into New Zealand dollars.

Recognition of income or expenditure – cash basis or accrual basis accounting

26. In New Zealand, the two main methods used to determine when an amount of income has been derived are the cash basis and the accrual basis. On a cash basis, income is derived when it is received. On an accrual basis, income is derived when it is earned, even if the income has not yet been received. Under New Zealand tax law, a variety of factors are considered when determining whether to adopt a cash basis or an accrual basis, including the type and scale of activity that gives rise to the income. The courts have held that a cash basis may be appropriate for an individual not carrying on a business. Ordinarily, an individual with one foreign residential rental property will not be carrying on a business and the cash basis will be appropriate.

27. For more information on determining the correct method to use, see Interpretation Statement "IS 16/06: Income tax – timing – when is income from professional services derived?", *Tax Information Bulletin* Vol 29, No 1 (February 2017): 9. Although the title of IS 16/06 refers to professional services, the principles it sets

out are equally applicable to deciding the correct basis for recognising rental income and expenses.

28. Although a cash basis or accruals basis might be the correct basis for you to use for New Zealand tax purposes, you should not assume that the same method will apply for the purposes of preparing your foreign tax accounts. Where the foreign method is different from what is required under New Zealand tax rules, you must complete new calculations for New Zealand tax purposes.

Balance dates

29. Another reason why tax accounts prepared for foreign tax purposes are unlikely to provide you with the correct taxable income amount for New Zealand tax purposes, is that they may have been prepared using a balance date different from that used in New Zealand.

30. While the standard New Zealand balance date is 31 March, the standard balance dates used for foreign tax purposes vary. For example, in Australia, the standard balance date is 30 June, while in the United States it is usually 31 December. This means the New Zealand 2019 tax year typically covers income and expenses for the period from 1 April 2018 to 31 March 2019, but for Australian and United States purposes, the periods are from 1 July 2018 to 30 June 2019 and 1 January 2019 to 31 December 2019, respectively.

31. A taxpayer can elect to return certain foreign-sourced income and expenses in the New Zealand tax year in which the foreign balance date falls (s EG 1). They make the election by including the foreign-sourced income and expenses in their income tax return for the New Zealand tax year – no formal election is required. For example, Australian rental income for the Australian 2019 tax year (1 July 2018 to 30 June 2019) could be returned as income in the New Zealand 2020 tax year (1 April 2019 to 31 March 2020) even though most of that income would usually be treated as derived in the New Zealand 2019 tax year.

32. This option cannot be used if you have net foreign income of more than NZD100,000. If, after making an election under s EG 1, you derive more than NZD100,000 net foreign income, the foreign source income must be returned in line with a New Zealand 31 March balance date. If this means foreign income or expenditure is now treated as being derived or incurred in a previous New Zealand tax year, then your income tax assessment for that earlier year also needs to be amended.

33. Although you may have made an election under s EG 1, you still need to ensure any deductions calculated and claimed in your foreign tax accounts are permitted under New Zealand tax law and that the foreign currency amounts used in the foreign tax accounts are correctly converted into New Zealand dollars.

Foreign exchange rates and conversion timing

34. Where you have foreign currency income and expenses, then New Zealand's tax rules require these amounts to be converted to New Zealand dollars for the purposes of calculating your New Zealand tax liability.

35. In some cases, the Act prescribes a currency conversion method or exchange rate source to use, but in most cases it does not. Where the Act does not prescribe a currency conversion method or exchange rate source the default method is the close of trading spot exchange rate on the date the amount is required to be

measured or calculated (s YF 1(2)). However, the Commissioner can approve other methods and rates to use (s YF 1(5)) to minimise compliance costs.

36. The Commissioner has approved annual and monthly currency conversion methods that may be used by individuals who own foreign rental property instead of or in conjunction with the spot rate, (see *Approval – foreign rental property amounts – currency conversion* (Approval). The Commissioner has also approved the foreign exchange rates published by Inland Revenue on its website (www.classic.ird.govt.nz/how-to/overseas-currency) for use by individuals who have an interest in a foreign rental property or exchange rates from another reputable source. For further guidance on the above currency conversion methods and exchange rate sources, see the Approval.

37. It is important to note that the Approval does not apply when converting foreign amounts to New Zealand dollars for the purposes of the FA rules. Where a foreign currency loan falls within the scope of the FA rules, foreign currency amounts must be converted to New Zealand dollars using the methods and rates prescribed under the FA rules (as discussed later in this item and in Interpretation Statement "IS 20/07: Income tax –Application of the financial arrangements rules to foreign currency loans used to finance foreign rental properties").

Income – three types covered in this item

38. This item covers the three types of income that may arise where a New Zealand tax resident owns a foreign rental property:

- foreign rental income;
- income from the sale of the property; and
- in some cases, FA income resulting from foreign exchange gains.

Foreign rental income

39. Unless you are within the transitional residency period, you will be required to pay tax on the foreign rental income you receive (s CC 1). This will be the case even if you are required to pay tax on that same rental income in the country where the property is located. However, where this occurs, you may be entitled to a foreign tax credit in New Zealand. The availability of foreign tax credits is discussed from [58].

Income from the sale of the property

40. If you sell your foreign residential rental property, you may be required to pay tax on any gain under New Zealand's land taxing provisions, even if the sale is not taxable in the country where the property is located. For example, you may be required to pay tax on a gain you make when you sell a foreign residential rental property:

- that you purchased with the purpose or intention of sale (s CB 6); or
- within five years, or two years if you purchased the property before 29 March 2018 (the s CB 6A "bright-line" test).

41. If you are a transitional resident, the sale of a foreign rental property during your transitional residency period will not be taxable in New Zealand even if it would ordinarily be caught by one of New Zealand's land taxing rules. However, the sale of that same property may be taxable if you sell it **after** the transitional residency

period has ended (assuming you have remained a New Zealand tax resident). This will be the case even if you purchased the property before or while you were a transitional resident. For property sold after the transitional residency period, the land taxing rules will apply as normal as you are no longer a transitional resident. For example, the bright-line test will include the period for which you were a transitional resident.

42. If the proceeds from the sale of a foreign rental property are taxed in New Zealand and in the country where the property is located, you may be entitled to a foreign tax credit. The availability of foreign tax credits is discussed from [58].

Financial arrangement income arising from foreign currency gains

43. The third type of income that may arise from owning a foreign rental property is income calculated under the FA rules, as a result of foreign exchange gains.

44. If you own a foreign rental property, you may also have a foreign currency loan from a foreign bank or other lender. Because a foreign currency loan will generally meet the definition of a "financial arrangement", you will need to consider whether the FA rules apply to that loan. Under the FA rules, an increase in the value of the New Zealand dollar will usually have the effect of lowering the interest expenditure you are deemed to have incurred on your foreign currency loan. However, if the foreign exchange gain is significant enough, the FA rules may deem you to have derived an amount of FA income from the foreign currency loan. Where this occurs, you will be liable for tax on that deemed FA income.

45. Because the application of the FA rules to foreign currency loans is complicated, the Commissioner has issued "IS 20/07: Income tax –Application of the financial arrangements rules to foreign currency loans used to finance foreign rental properties" in conjunction with this general item.

Expenses

46. When calculating your taxable income from a foreign rental property, you are generally entitled to claim deductions available under New Zealand tax law. Because the rules on deductibility vary greatly from country to country, do not assume that deductions you are permitted for foreign tax purposes will be allowed under New Zealand's tax rules to the same extent or in the same way. If your deductible expenses relating to residential rental property (including foreign residential rental property) exceed your rental income and/or gains on the sale of residential rental property, the deductions that can be allocated to the income year may be limited. Residential rental property deductions are generally "ring-fenced", meaning they can only be used against income from residential property, with any deductions in excess of the income being carried forward to the next income year you derive income from residential property. Note, these ring-fencing rules do not apply to residential property that comes under the mixed-use asset rules. For further information on the residential ring-fencing rules, see *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.

47. Note that because foreign-sourced income, such as foreign rental income, derived by a transitional resident is exempt income, transitional residents are not permitted to claim any deductions for expenses incurred in deriving that income (s DA 2(3)).

Repairs and maintenance

48. Whether an expense is repairs and maintenance or a capital improvement will make a difference to how that expense is treated for tax purposes. Unlike capital

improvement expenses, repairs and maintenance expenses can generally be deducted in the year they are incurred. While New Zealand's rules for differentiating between repairs and maintenance and capital improvement expenses may appear to be the same as those applied in the country where your rental property is located, do not assume they are identical in every case. For example, some countries, such as the United States, may also allow you to deduct capital improvement expenses under a certain dollar amount as if they were repairs and maintenance expenses.

49. For further information on New Zealand's repairs and maintenance rules, see Interpretation Statement "IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68. Information in "QB 20/01: Can owners of existing residential properties claim deductions for costs incurred to meet Healthy Homes standards?" on the approach for determining capital and revenue expenses may also be helpful, although to the extent that QB 20/01 discusses New Zealand's healthy homes standards it will not be directly applicable.

Depreciation

50. Under New Zealand tax law, you are not permitted to claim a deduction for the depreciation of a residential rental property (the building or the land), although deductions are permitted on the depreciation of chattels in a rental property such as furniture or appliances. Generally, an annual deduction amount is calculated using a rate set by Inland Revenue based on the estimated useful life of a chattel. Note that depreciation rates may vary between the country where the property is located and New Zealand. For example, for New Zealand depreciation purposes, a domestic refrigerator has an estimated useful life of eight years. The same refrigerator, however, has a 12-year estimated useful life under the Australian depreciation rules.

51. The cost of low-value items may be deducted in full in the year they are purchased. Low-value items are items that cost:

- $500 or less, for chattels acquired on or after 19 May 2005 and before 17 March 2020;
- $5,000 or less, for chattels acquired on or after 17 March 2020 and before 17 March 2021;
- $1,000 or less, for chattels acquired on or after 17 March 2021 (s EE 38).

52. For items purchased using foreign currency, the cost will need to be converted to NZD to determine if the thresholds apply.

53. For further information on New Zealand's depreciation rules for residential rental properties, see Interpretation Statement "IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16 and Inland Revenue guide "IR264 Rental income – tax rules for people who rent out residential property and holiday homes" April 2020. As already noted, information in QB 20/01 on the approach for determining capital and revenue expenses may also be helpful.

Interest deductions

54. Under New Zealand tax law, the interest on a loan financing a rental property, including a foreign rental property, can generally be claimed as a deduction against your rental income. New Zealand's rules on interest deductions may not be the

same as those in other jurisdictions. For example, under United Kingdom tax law, instead of deductions for interest paid on rental property loans, taxpayers receive a tax credit based on 20% of their interest payments.

55. Note that where you have a foreign currency loan, you may be required to apply the FA rules to calculate your expenditure (or income) on the loan. Under the FA rules, foreign exchange movements will affect the amount of deemed interest expenditure you have on your foreign currency loan. For more information on applying the FA rules to foreign currency loans, see "IS 20/07: Income tax – Application of the financial arrangements rules to foreign currency loans used to finance foreign rental properties".

Mixed-use assets

56. New Zealand's mixed-use asset rules apply to assets (including foreign assets) that are used to earn income, used privately, and are unused for 62 days or more during the year. The rules ensure an appropriate proportion of the expenses that relate to the "unused" period is not deductible. The proportion that is deductible is based on the amount of income-earning use relative to the total use of the asset. If you own a foreign property, consider the mixed-use asset rules as if the property were in New Zealand. Note, the ring-fencing rules for residential property deductions do not apply to mixed-use assets.

57. For further information on the mixed-use asset rules, see Questions We've Been Asked "QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?", *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.

Entitlement to foreign tax credits

58. Foreign tax credits help alleviate double taxation where a person is taxed on the same income by two countries. Double taxation may arise for New Zealand tax residents with rental income or gains from foreign property. This is because New Zealand tax residents are taxed on their worldwide income in New Zealand and because they are also likely to be taxed on any income or gains from foreign property in the country where the land is situated. Therefore, it is important for New Zealand tax residents to understand whether they are eligible for foreign tax credits in New Zealand to offset the foreign tax they have paid.

59. You may be entitled to claim a foreign tax credit, to the extent that tax is paid on the same income in New Zealand in two circumstances. If the foreign tax on rental income and/or gains on land sales:

    (a) is covered by a DTA, a credit may be allowed under and in accordance with the terms of that DTA; or

    (b) is not covered by a DTA, a foreign tax credit may be allowed directly under subpart LJ.

60. A foreign tax credit is matched with the income year in which the foreign income on which the foreign tax was paid is derived for New Zealand tax purposes. If the foreign tax is not paid until after the income year in which you are required to return the foreign income for New Zealand tax purposes, you may have to apply to the Commissioner to amend your income tax assessment for the year to give credit for the foreign tax paid. The application must be made within the time limit prescribed in s 78B of the Tax Administration Act 1994 (TAA). For more

information on claiming foreign tax credits, see Interpretation Statements "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 and "IS 16/05: Income tax – foreign tax credits – how to claim a foreign tax credit where the foreign tax paid is covered by a double tax agreement", *Tax Information Bulletin* Vol 28, No 12 (December 2016): 41.

Preliminary requirements

Residents other than transitional residents

61. Regardless of whether tax on foreign rental income or gains on foreign property is covered by a DTA, the following requirements must be met before a taxpayer is eligible for a foreign tax credit. You must:

    (a) be a New Zealand tax resident;

    (b) have derived foreign-source income that is taxable in New Zealand and in another country; and

    (c) have paid foreign income tax on that foreign-source income.

62. If any of these requirements is not met, you will not be entitled to a foreign tax credit.

63. In the case of gains from land sales, it depends on the circumstances of each sale as to whether the proceeds will be taxable in New Zealand. For example, residential land sold within the bright-line period (see [40]) will be subject to New Zealand tax (s CB 6A). However, if the same land were sold after the bright-line period, the proceeds would not be assessable in New Zealand (assuming no other land taxing provisions applied). Therefore, it cannot be assumed that because land sale proceeds are subject to foreign tax, that the same amount will necessarily be assessable income in New Zealand (and vice versa).

Transitional residents

64. Because transitional residents are exempt from tax on almost all foreign-source income during the transitional residency period, including foreign rental income and gains on foreign land sales, transitional residents are not entitled to a foreign tax credit for any foreign tax they have paid on that income.

Tax covered by a double tax agreement

Examples of taxes covered in specific agreements

65. If a DTA is in force between New Zealand and the country where tax on foreign rental income or gains from land sales has been paid, the first step is to check that the tax paid is covered by the DTA.

66. The relevant article in the DTA is usually entitled "Taxes covered" and is typically article 2. Depending on the wording of the DTA, tax on foreign rental income and gains from land sales will be covered by the DTA, if they are:

    (a) expressly listed as taxes covered; or

    (b) a tax on income or capital as defined in article 2(1) and (2) of the DTA; or

(c) a subsequently enacted tax that is "identical or substantially similar" to one of the taxes expressly covered (article 2(4)).

67. The following illustrates the way foreign rental income and land sales proceeds are covered under several common DTAs:

(a) **Australia–New Zealand DTA** – Under article 2 of this DTA, federal tax paid in Australia on Australian-sourced rental income and gains from land sales are covered by the DTA. Therefore, foreign tax credits are available to New Zealand tax residents, to the extent calculated under the Act. Although Australian tax on gains from land sales is not specifically referred to in this DTA, it is treated as income tax for the purposes of applying the DTA because Australia's capital gains tax is incorporated into its federal income tax legislation.

(b) **China–New Zealand DTA** – Under article 2 of this DTA, tax paid in China on China-sourced rental income and gains from land sales are specifically covered by the DTA. Therefore, foreign tax credits are available to New Zealand tax residents, to the extent calculated under the Act.

(c) **United States – New Zealand DTA** – Under article 2 of this DTA, federal tax paid on United States–sourced rental income and tax on gains from land sales are covered by the DTA. Therefore, foreign tax credits for these taxes are available to New Zealand tax residents, to the extent calculated under the Act.

(d) **United Kingdom – New Zealand** – Under article 2 of this DTA, tax paid on United Kingdom–sourced rental income and gains from land sales are specifically covered by the DTA. Therefore, foreign tax credits are available to New Zealand tax residents, to the extent calculated under the Act.

68. For further discussion on the availability of foreign tax credits under a DTA, see Interpretation Statement IS 16/05.

Residency of a taxpayer for the purposes of a double tax agreement

69. If the tax paid is covered by a DTA, it becomes necessary to determine if the taxpayer is a New Zealand tax resident under that DTA.

70. If the taxpayer is tax resident in only New Zealand, there is no need to consider the residency article under the DTA. However, if a taxpayer is tax resident in New Zealand and in the foreign country, the residency article of the DTA determines which of the two countries the taxpayer is treated as being tax resident of for the purposes of the DTA. Usually, residency is decided in the first instance by asking in which of the two countries does the taxpayer have a permanent home available to them.

71. If the taxpayer has a permanent home in both countries, the residency article of a DTA typically sets out a series of tie-breaker tests that ultimately decide which country the taxpayer will be resident in for the purposes of the DTA. See the detailed discussion on how the tie-breaker tests commonly found in DTAs apply in IS 16/05.

Allocation of taxing rights under a double tax agreement

72. If the tax is covered by the DTA and the taxpayer is a New Zealand tax resident for the purposes of the DTA, the next step is to determine whether one or both countries have the right to tax the income in question. In general, New Zealand's

DTAs allocate taxing rights on rental income and gains from land sales to the country where the land is located. However, New Zealand retains the right to tax its residents on their world-wide income. This means for foreign rental income and gains from land sales, both New Zealand and the other country have shared rights to tax. Therefore, there will often be "double taxation" on these amounts, and it is necessary to consider the "elimination of double taxation" article to the DTA (if such an article is included in the DTA).

73. As the name suggests, the elimination of double taxation article generally provides that where a person is a New Zealand tax resident for the purposes of the DTA and they are taxed by both countries on the same income, New Zealand will provide the taxpayer with a tax credit for the tax paid in the other country, to the extent that tax is payable on the same income in New Zealand. This is also subject to any limitations found in the specific DTA or New Zealand's domestic legislation. For a detailed discussion on calculating the foreign tax credits a taxpayer is entitled to, see IS 16/05. If the tax paid in the foreign country is less than the tax payable on the same income in New Zealand, the difference is payable as tax in New Zealand.

Tax not covered by a double tax agreement

74. In some cases, tax paid on foreign rental income or gains from land sales overseas may not be covered by a DTA. This will usually be because New Zealand does not have a DTA with the country where the tax is paid. However, there may be situations where New Zealand does have a DTA with a particular country, but the tax paid is not of a type covered by the articles of that DTA.

75. In either case, a taxpayer may still be entitled to a foreign tax credit under subpart LJ. The central issue for foreign taxes not covered by a DTA is whether the tax paid is tax of "substantially the same nature" as income tax imposed under s BB 1 (ss LJ 3 and YA 2(5)).

76. For further guidance on deciding whether tax paid on foreign rental income or gains from land sales overseas will be eligible for a foreign tax credit in New Zealand, 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.

Other New Zealand tax obligations

Provisional tax

77. If you have an end-of-year tax bill (your residual income tax) of more than NZD5,000 for any reason (this may be as a result of foreign rental income, gains on the sale of a foreign rental property, or otherwise), you must pay income tax for the following year in instalments (provisional tax), rather than at the end of the year in a lump sum. The NZD5,000 threshold applies for the 2021 and later income years. For income years before 2021, the threshold was NZD2,500. For further information on provisional tax, including the methods for calculating provisional tax payments, and when such payments are due, see the Inland Revenue website (https://www.ird.govt.nz/topics/income-tax/provisional-tax) and the IR289 Provisional Tax guide.

Obligation to withhold Non-Resident Withholding Tax

78. It is common for people who own a foreign rental property to have a loan from a non-resident lender. In these situations, because a New Zealand tax resident

borrower will be paying interest to a non-resident, the New Zealand tax resident may be required to withhold NRWT from the interest paid, and to pay the tax withheld to Inland Revenue. This is unless they use the borrowed money for the purposes of a business they carry on outside New Zealand through a fixed establishment outside New Zealand (s YD 4(11)(b)(i)). As noted at [26], ordinarily, an individual with one foreign residential rental property will not be carrying on a business.

79. Another exception to the requirement to withhold is where the non-resident lender is a registered bank engaged in business in New Zealand through a fixed establishment in New Zealand and is not associated with the borrower (s RF 2(2B)). The most common form of a "fixed establishment" will be a branch. For example, most Australian registered banks engage in business in New Zealand through a branch. However, note that some banks carry on business in New Zealand using a subsidiary company rather than a branch. Where a subsidiary is used, the non-resident lender is unlikely to have a fixed establishment in New Zealand. A list of the banks registered in New Zealand, and whether they operate in New Zealand through a branch or a subsidiary, is on the Reserve Bank of New Zealand's website (www.rbnz.govt.nz/regulation-and-supervision/banks/register). The rate of NRWT that must be withheld depends on whether New Zealand has a DTA with the country or territory where the lender is resident:

- If the lender is from a non-DTA country or territory, then the rate of NRWT is 15%.
- If the lender is from a DTA country or territory, then the rate of NRWT will be set by the DTA (often 10%).

80. A lender may require interest payments to be grossed-up to cover the NRWT withheld. For example, for an interest payment of AUD2,000 subject to NRWT at 10%, the gross amount of interest would be AUD2,222, calculated as follows:

$$\text{AUD}2{,}000 \times \frac{100}{90} = \text{AUD}2{,}222$$

81. The amount of NRWT would be AUD222.22 (10% of AUD2,222).

82. From 1 April 2020, if you are required to withhold NRWT from interest you pay, you must provide Inland Revenue with information about the interest and the lender you pay it to (investment income information). The information must be provided electronically by the 20th of the month following the month in which you pay the interest.

83. If you are a transitional resident and are paying interest to a non-resident lender in relation to money borrowed while you were non-resident, the NRWT on interest payments is 0% (s RF 12). Practically, this means you are not required to deduct NRWT from the interest payments you make to the non-resident lender while you are a transitional resident.

84. Instead of withholding NRWT, you may request approval from Inland Revenue to pay a 2% approved issuer levy (AIL). For more information see "IR395 Approved issuer levy (AIL), a guide for payers" April 2019.

85. For more information on NRWT and investment income information, see "IR291 NRWT – payer's guide" March 2020.

Examples

86. The following examples illustrate the application of the law in relation to tax issues arising from ownership of foreign rental property.

Example 1

Manuel is a tax resident of the United Kingdom (UK). He migrates to New Zealand to take up a new job. Manuel becomes a New Zealand tax resident on 30 September 2017. Manuel has never been a New Zealand tax resident before and is eligible to be a transitional resident. Manuel has a house in the UK that he rents out. He also has a GBP300,000 loan with a UK bank. The UK bank does not have a branch in New Zealand. For the purposes of the FA rules, Manuel is a cash basis person.

For the 48-month period (beginning on 30 September 2017) that Manuel is a transitional resident:

- he will not be liable for New Zealand tax on the foreign rental income he receives from his UK property;
- the GBP300,000 loan will be an excepted financial arrangement, so is not subject to the FA rules;
- he is not required to withhold NRWT on the interest paid to the UK bank.

Manuel will still be liable for tax in the UK on the rental income he earns from his UK property.

After the transitional period, Manuel continues to be a New Zealand tax resident. Because Manuel is no longer entitled to the transitional resident exemption on foreign income the following occurs:

- Manuel is required to return the rental income he receives on his UK property in New Zealand. Because of the difference between New Zealand and UK tax laws, Manuel prepares two sets of tax accounts: one set is prepared applying UK tax rules and the other applying New Zealand tax rules. Under the UK–New Zealand DTA, to the extent that Manuel pays UK tax on this rental income, he is entitled to claim a foreign tax credit to the extent permitted under subpart LJ.
- Manuel's loan is no longer an excepted financial arrangement, so he must consider the application of the FA rules to that loan. As a cash basis person, Manuel is required to do a base price adjustment only if he ceases to be a New Zealand tax resident or if the loan matures. Neither of these events occurs in this tax year, so Manuel is not required to make any calculations under the FA rules.
- Manuel is required to withhold NRWT from the interest he pays on his loan and pay these deducted amounts to New Zealand Inland Revenue and provide the required investment income information. Under the UK–New Zealand DTA, Manuel is required to withhold NRWT at a rate of 10%. The UK bank requires Manuel to gross-up the interest he pays to cover the amount of NRWT he withholds. Manuel's monthly interest payments are GBP1,151. Grossed-up monthly payments are GBP1,278.89:

$$\text{GBP}1{,}151 \times \frac{100}{90} = \text{GBP}\underline{1{,}278.89}$$

  Manuel must withhold GBP127.89 NRWT from each payment.

Example 2

Mei migrated to New Zealand just over four years ago. Her status as a transitional resident ended on 31 August 2017. She still owns an apartment in Shanghai that she rents out. As at 1 September 2017, Mei had a RMB2,500,000 loan from a Chinese bank that does not have a fixed establishment in New Zealand.

Although Mei had not been required to withhold NRWT from the interest payments she made on her Chinese bank loan while she was a transitional resident, she is now required to do so. Under the China–New Zealand DTA, Mei needs to withhold NRWT at 10%. Because the NRWT she will deduct in the year is likely to exceed NZD500, she will need to pay the NRWT she withholds to New Zealand Inland Revenue monthly. She will need to provide investment income information to the Commissioner by the 20th of the month following the month in which she pays interest to the Chinese bank.

As Mei is a New Zealand tax resident, the rental income she receives from her Shanghai apartment is taxable in New Zealand. However, she is entitled to claim deductions for expenses incurred in deriving that rental income, as if the apartment were located in New Zealand. Under the China–New Zealand DTA, Mei will be entitled to claim a foreign tax credit in New Zealand for tax paid in China on the same rental income, as calculated under subpart LJ.

Depending on the value of Mei's other financial arrangements, both in New Zealand and overseas, she may also have foreign exchange income or expenses arising from her loan, as calculated under Determination G9A and the FA rules.

Example 3

Megan has been New Zealand tax resident all her life. She recently purchased a Gold Coast property that she uses as a holiday home three months of the year. For the other nine months of the year, the property is listed for rent on a short-stay accommodation website.

Megan financed the purchase of the property with an AUD400,000 loan from an Australian bank. The Australian bank has a branch in New Zealand. After four years, Megan sells the Australian property and makes an AUD50,000 profit.

For the four years the property is rented out, Megan must return the rental income in New Zealand and Australia. Megan files her New Zealand tax returns for the 1 April to 31 March New Zealand tax year by the 7 July deadline. She files her Australian tax returns for the 1 July to 30 June Australian tax year by the 31 October deadline. To make sure she complies with both Australian and New Zealand tax laws, she prepares separate tax accounts for each country. In each year Megan's rental income exceeds her rental expenditure so that for New Zealand tax purposes she has no ring-fenced deductions to carry forward under Subpart EL. When converting Australian dollar amounts into New Zealand dollar amounts for the purposes of preparing her New Zealand tax accounts, Megan applies the Approval for foreign rental property amounts and uses the monthly rate. Under the Australian–New Zealand DTA, Megan is eligible for a foreign tax credit for the Australian tax she pays on the rental income from the property to the extent calculated under subpart LJ. Because Megan returns the foreign rental income for New Zealand tax purposes before she pays Australian tax on it, Megan must apply to the Commissioner to amend her New Zealand tax returns to give

credit for the Australian tax after she has paid it. She must make the application within the time limit prescribed in s 78B of the TAA.

Megan is not required to withhold NRWT from the interest payments she makes to the Australian bank or to provide investment income information to the Commissioner. The interest payments are not classed as non-resident passive income because they are being paid to a non-resident registered bank that is engaged in business in New Zealand through a fixed establishment in New Zealand, in this case, a branch.

Because Megan sold the Gold Coast property within five years of purchase, she is liable for tax in New Zealand on the AUD50,000 gain she made on the sale under s CB 6A. Megan is also liable to pay tax on the same gain in Australia. Under the Australian–New Zealand DTA she will be eligible for a tax credit on the rental income and the gain from the sale of the property to the extent calculated under subpart LJ. As with previous income years, because Megan returns the foreign rental income and gain for New Zealand tax purposes before she pays Australian tax on those amounts, Megan must apply to the Commissioner to amend her New Zealand tax return to give credit for the Australian tax once she has paid it.

Megan is a cash basis person. As a cash basis person, she is required to make a base price adjustment because she repaid her Australian loan in full on selling her Gold Coast property. Since she took out her loan, the New Zealand dollar has strengthened against the Australian dollar. After calculating the base price adjustment, Megan finds she has derived financial arrangement income, which she returns in the relevant income year. As a result of making a gain on the sale of the Gold Coast property, and deriving financial arrangement income, it is likely that Megan will have residual income tax greater than NZD5,000 for that year. Megan therefore needs to consider how the provisional tax rules apply to her.

References

Subject references

Foreign property
Foreign tax credits
Non-resident withholding tax
Transitional residents

Legislative references

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