**Note (not part of the Rulings):**

These five public rulings, BR Pub 10/01 to BR Pub 10/05, deal with the ability of a New Zealand resident partner of an Australian limited partnership to claim foreign tax credits in respect of two forms of Australian tax, including Australian company tax, paid on income earned by an Australian limited partnership. It does not consider any other situations involving foreign income and foreign tax paid. The particular focus is on Australian limited partnerships that are corporate limited partnerships for Australian tax purposes and are treated under Australian tax law as companies while in New Zealand they retain partnership and flow through tax treatment.

A foreign tax credit will be available to the New Zealand partners when the tax paid is equivalent to New Zealand income tax or non-resident withholding tax and it is paid in respect of foreign income that is assessable in New Zealand.

The differing ways in which the income can be earned, and tax can be paid, by an Australian limited partnership means it is appropriate to issue five rulings covering various situations. However, a single commentary applies to all five rulings.

The Income Tax Assessment Act 1936, Income Tax Assessment Act 1997 and Income Tax Rates Act 1986 are all Australian legislation.

# AUSTRALIAN SOURCE INCOME EARNED BY AUSTRALIAN LIMITED PARTNERSHIP AND FOREIGN TAX CREDITS

## PUBLIC RULING – BR Pub 10/01

This is a public ruling made under section 91D of the Tax Administration Act 1994.

### Taxation Laws

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

This ruling applies in respect of sections HG 2 and LJ 1.

### Definitions

For the purpose of this ruling:

- **Limited partnership** means a partnership that does not meet the definition of company under section YA 1 and under Division 5A of the Income Tax Assessment Act 1936 (Aust) is defined as a corporate limited partnership and treated as a company for Australian income tax purposes.

- **New Zealand partner** means a partner that is resident under section YD 1 (residence of natural persons) or section YD 2 (residence of companies) and is not treated as non-resident under a double tax agreement.

- **Australian income tax** means tax paid to the Australian Government that meets the definition of income tax in section YA 2(5).

- **Australian company tax** means tax levied under section 23(2) of the Income Tax Rates Act 1986 (Aust).

- **Partnership share** is defined in section YA 1 as meaning for a particular right, obligation, or other property, status or thing, the share that a partner has in respect of it.

**The Arrangement to which this Ruling applies**

The Arrangement is as follows:

- Australian source income is earned by an Australian limited partnership that is income to the New Zealand partners under section HG 2 and CB 35.

- Australian income tax, in the form of Australian company tax, is paid on that income.

For the avoidance of doubt the Arrangement does not include arrangements where subpart BG of the Act applies to void the arrangement.

**How the Taxation Laws apply to the Arrangement**

The Taxation Laws apply to the Arrangement as follows:

- New Zealand partners in the limited partnership are allowed a foreign tax credit under sections LJ 1 and HG 2 for the Australian income tax paid, in proportion to their partnership share of the income earned by the partnership.

**The period or income year for which this Ruling applies**

This ruling will apply from the first day of the 2009/10 income year to the last day of the 2012/13 income year.

This ruling is signed by me on the 25th day of March 2010.

Susan Price
**Director, Public Rulings**

# DISTRIBUTIONS MADE BY AUSTRALIAN LIMITED PARTNERSHIP AND FOREIGN TAX CREDITS

## PUBLIC RULING – BR Pub 10/02

This is a public ruling made under section 91D of the Tax Administration Act 1994.

### Taxation Laws

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

This ruling applies in respect of sections HG 2 and LJ 1.

### Definitions

For the purpose of this ruling:

- **Limited partnership** means a partnership that does not meet the definition of company under section YA 1 and under Division 5A of the Income Tax Assessment Act 1936 (Aust) is defined as a corporate limited partnership and treated as a company for Australian income tax purposes.

- **New Zealand partner** means a partner that is resident under section YD 1 (residence of natural persons) or section YD 2 (residence of companies) and is not treated as non-resident under a double tax agreement.

- **Australian income tax** means tax paid to the Australian Government that meets the definition of income tax in section YA 2(5).

- **Dividend withholding tax** means the amount withheld from a dividend to discharge the liability to pay tax in respect of dividends under section 128B of the Income Tax Assessment Act 1936 (Aust).

- **Partnership share** is defined in section YA 1 as meaning for a particular right, obligation, or other property, status or thing, the share that a partner has in respect of it.

## The Arrangement to which this Ruling applies

The Arrangement is as follows:

- An Australian limited partnership makes a distribution to its partners in respect of which the New Zealand partners are not liable for New Zealand income tax on their partnership share of that distribution.

- Australian income tax in the form of dividend withholding tax is deducted from the payments made to the New Zealand resident partners.

For the avoidance of doubt the Arrangement does not include arrangements where subpart BG of the Act applies to void the arrangement.

## How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- New Zealand partners in the limited partnership are not allowed a foreign tax credit under sections LJ 1 and HG 2, for the Australian income tax paid, in relation to the distribution made by the limited partnership.

## The period or income year for which this Ruling applies

This ruling will apply from the first day of the 2009/10 income year to the last day of the 2012/13 income year.

This ruling is signed by me on the 25th day of March 2010.

Susan Price
**Director, Public Rulings**

## DISTRIBUTIONS MADE BY AUSTRALIAN UNIT TRUST TO AUSTRALIAN LIMITED PARTNERSHIP AND FOREIGN TAX CREDITS

### PUBLIC RULING – BR Pub 10/03

This is a public ruling made under section 91D of the Tax Administration Act 1994.

### Taxation Laws

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

This ruling applies in respect of sections HG 2 and LJ 1.

### Definitions

For the purpose of this ruling:

- **Limited partnership** means a partnership that does not meet the definition of company under section YA 1 and under Division 5A of the Income Tax Assessment Act 1936 (Aust) is defined as a corporate limited partnership and treated as a company for Australian income tax purposes.

- **New Zealand partner** means a partner that is resident under section YD 1 (residence of natural persons) and is not treated as non-resident under a double tax agreement.

- **Australian income tax** means tax paid to the Australian Government that meets the definition of income tax in section YA 2(5).

- **Australian company tax** means tax levied under section 23(2) of the Income Tax Rates Act 1986 (Aust).

- **Partnership share** is defined in section YA 1 as meaning for a particular right, obligation, or other property, status or thing, the share that a partner has in respect of it.

## The Arrangement to which this Ruling applies

The Arrangement is as follows:

- A distribution, which is a dividend under section CD 1, is made by a unit trust to an Australian limited partnership.

- The limited partnership pays Australian income tax, in the form of Australian company tax on that distribution.

For the avoidance of doubt the Arrangement does not include arrangements where subpart BG of the Act applies to void the arrangement.

## How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- New Zealand partners in the limited partnership are allowed a foreign tax credit under section LJ 1 and HG 2, for the Australian income tax paid, in proportion to their partnership share of the dividend income received by the limited partnership.

## The period or income year for which this Ruling applies

This ruling will apply from the first day of the 2009/10 income year to the last day of the 2012/13 income year.

This ruling is signed by me on the 25th day of March 2010.

Susan Price
**Director, Public Rulings**

# FRANKED DIVIDEND RECEIVED BY AUSTRALIAN LIMITED PARTNERSHIP AND FOREIGN TAX CREDITS

## PUBLIC RULING – BR Pub 10/04

This is a public ruling made under section 91D of the Tax Administration Act 1994.

### Taxation Laws

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

This ruling applies in respect of sections HG 2 and LJ 1.

### Definitions

For the purpose of this ruling:

- **Limited partnership** means a partnership that does not meet the definition of company under section YA 1 and under Division 5A of the Income Tax Assessment Act 1936 (Aust) is defined as a corporate limited partnership and treated as a company for Australian income tax purposes.

- **New Zealand partner** means a partner that is resident under section YD 1 (residence of natural persons) and is not treated as non-resident under a double tax agreement.

- **Australian income tax** means tax paid to the Australian Government that meets the definition of income tax in section YA 2(5).

- **Franking credit** for Australian tax purposes is defined in section 205-15 of the Income Tax Assessment Act 1997 (Aust).

- **Partnership share** is defined in section YA 1 of the Act as meaning for a particular right, obligation, or other property, status or thing, the share that a partner has in respect of it.

**The Arrangement to which this Ruling applies**

The Arrangement is as follows:

- An Australian limited partnership receives a dividend that has a franking credit attached.

- The New Zealand partners are liable to tax on their partnership share of the dividend received by the limited partnership under sections HG 2 and CD 1.

For the avoidance of doubt the Arrangement does not include arrangements where subpart BG of the Act applies to void the arrangement.

**How the Taxation Laws apply to the Arrangement**

The Taxation Laws apply to the Arrangement as follows:

- New Zealand resident partners in the limited partnership are not allowed a foreign tax credit under sections LJ 1 or HG 2, in relation to the franking credit attached to the dividend received by the limited partnership.

**The period or income year for which this Ruling applies**

This ruling will apply from the first day of the 2009/10 income year to the last day of the 2012/13 income year.

This ruling is signed by me on the 25th day of March 2010.

Susan Price
**Director, Public Rulings**

## TAX PAID BY AN AUSTRALIAN LIMITED PARTNERSHIP AS A "HEAD COMPANY" AND FOREIGN TAX CREDITS

### PUBLIC RULING – BR Pub 10/05

This is a public ruling made under section 91D of the Tax Administration Act 1994.

### Taxation Laws

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

This ruling applies in respect of sections HG 2 and LJ 1.

### Definitions

For the purpose of this ruling:

- **Limited partnership** means a partnership that does not meet the definition of company under section YA 1 and under Division 5A of the Income Tax Assessment Act 1936 (Aust) is defined as a corporate limited partnership and treated as a company for Australian income tax purposes.

- **New Zealand partner** means a partner that is resident under either section YD 1 (residence of natural persons) or section YD 2 (residence of companies) and is not treated as non-resident under a double tax agreement.

- **Australian income tax** means tax paid to the Australian Government that meets the definition of income tax in section YA 2(5).

- **Australian company tax** means tax levied under section 23(2) of the Income Tax Rates Act 1986 (Aust).

- **Partnership share** is defined in section YA 1 as meaning for a particular right, obligation, or other property, status or thing, the share that a partner has in respect of it.

### The Arrangement to which this Ruling applies

The Arrangement is as follows:

- An Australian limited partnership is a head company under section 703-15(2) of the Income Tax Assessment Act 1997 (Aust).

- The limited partnership pays income tax, in the form of Australian company tax, in Australia on all the taxable income of the consolidated group.

- The taxable income of the consolidated group in Australia includes income, such as business income earned by Australian subsidiary companies, which does not form part of the New Zealand partners' partnership share of the partnership income under sections HG 2 and CB 35.

For the avoidance of doubt the Arrangement does not include arrangements where subpart BG of the Act applies to void the arrangement.

**How the Taxation Laws apply to the Arrangement**

The Taxation Laws apply to the Arrangement as follows:

- New Zealand partners in the limited partnership are allowed a foreign tax credit under sections LJ 1 and HG 2 for the Australian income tax paid by the limited partnership to the extent that the Australian income tax is paid in relation to their partnership share of the income earned by the partnership under sections HG 2 and CB 35.

- New Zealand partners in the limited partnership are not allowed a foreign tax credit under sections LJ 1 and HG 2 for the Australian income tax paid by the limited partnership to the extent that the Australian income tax is not paid in relation to their partnership share of the income earned by the partnership under sections HG 2 and CB 35.

**The period or income year for which this Ruling applies**

This ruling will apply from the first day of the 2009/10 income year to the last day of the 2012/13 income year.

This ruling is signed by me on the 25th day of March 2010.

Susan Price
**Director, Public Rulings**

## COMMENTARY ON PUBLIC RULINGS BR 10/01 to BR 10/05

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in the five public rulings BR Pub 10/01 to BR 10/05.

### SUMMARY

Foreign tax credits for Australian tax paid by Australian limited partnerships are available to New Zealand resident partners, in proportion to their partnership share, when all the following are met:

- the Australian limited partnership is treated as a company for Australian income tax purposes but not for New Zealand tax purposes;

- the Australian tax paid, by or on behalf of the Australian limited partnership, is the equivalent of income tax or non-resident withholding tax;

- the income on which the tax was paid is assessable in New Zealand; and

- the Australian tax paid was paid on the income that is assessable in New Zealand.

### BACKGROUND

The question being considered is whether a foreign tax credit is available to New Zealand residents that earn Australian source income through a limited partnership registered in a state of Australia (that is an Australian limited partnership). The Australian limited partnerships that are under consideration are ones that are treated as corporate limited partnerships for Australian income tax purposes, under section 94D of the Income Tax Assessment Act 1936 (Aust), but do not meet the definition of "company" in section YA 1 of the Income Tax Act 2007. Before looking at the relevant foreign tax credit legislation in New Zealand law, the underlying Australian law surrounding limited partnerships registered in Australia, as well as their tax treatment in Australia, needs to be considered.

### AUSTRALIAN PARTNERSHIPS

Three forms of Australian partnerships exist:

- (ordinary) partnerships[1];
- limited partnerships; and
- incorporated limited partnerships.

[1] Referred to as "partnerships" in Australian state legislation.

**(Ordinary) partnerships**

The regulation of partnerships in Australia falls under State law which includes the:

- Partnership Act 1958 (Victoria);
- Partnership Act 1892 (New South Wales);
- Partnership Act 1891 (Queensland);
- Partnership Act 1963 (Australian Capital Territory);
- Partnership Act 1891 (South Australia);
- Partnership Act 1891 (Tasmania);
- Partnership Act 1997 (Northern Territory); and
- The Partnership Act 1895 (Western Australia).

These Acts provide that an ordinary partnership is one where the partners are jointly and severally liable for the legal actions and debts of the partnership, have management control, share the profits of the firm in predefined proportions, and have apparent authority as agents of the firm to bind all the other partners in contracts with third parties. An ordinary partnership is not a separate legal entity.

**Limited partnerships**

Limited partnerships in Australia can be formed and registered only under:

- Part 3, sections 49 -79 Partnership Act 1958 (Victoria)
- Part 3, sections 50A – 81A Partnership Act 1892 (New South Wales)
- Chapter 3, sections 48 – 69 Partnership Act 1891 (Queensland)
- Part 3, sections 47-84 - Partnership Act 1891 (South Australia)
- Limited Partnership Act, 1908 (Tasmania)
- Limited Partnership Act, 1909 (Western Australia).

Neither the partnership laws of the Australian Capital Territory nor the Northern Territory have provision for limited partnerships although the Australian Capital Territory and the Northern Territory have provision for incorporated limited partnerships, as do New South Wales, Queensland, Victoria and South Australia mentioned below.

The provisions, listed above, provide that a limited partnership is one where there are both general partners and limited partners. The general partners have the rights and obligations as in an ordinary partnership. The limited partners are not jointly and severally liable for the debts of the partnership and their exposure is limited to their partnership investments, and a corresponding share of the profits. They also cannot participate in the management of the company or act as agents for the partnership. Despite the limited liability of the limited partners the limited partnership, which is not also an incorporated limited partnership, does not have a separate legal identity.

## Incorporated limited partnerships

An incorporated limited partnership is a partnership which must have at least one general partner and one limited partner and the partnership is a separate legal entity with the powers and capacity of a natural person subject to the limitations in the partnership agreement.

## AUSTRALIAN TAX TREATMENT OF AUSTRALIAN LIMITED PARTNERSHIPS

A "limited partnership" is defined in section 995-1 of the Income Tax Assessment Act 1997 (Aust)[2] as:

> (a) an association of persons (other than a company) carrying on business as partners or in receipt of ordinary income or statutory income jointly, where the liability of at least one of those persons is limited; or
>
> (b) an association of persons (other than one referred to in paragraph (a)) with legal personality separate from those persons that was formed solely for the purpose of becoming a VCLP, an ESVCLP, an AFOF or a VCMP and to carry on activities that are carried on by a body of that kind.[3]

## Corporate limited partnerships

Section 94D of Division 5A of the Income Tax Assessment Act 1936 (Aust), Income of Certain Limited Partnerships, provides that a limited partnership is a corporate limited partnership if it is an association of persons (other than a company) carrying on business as partners or in receipt of ordinary or statutory income jointly where the liability of at least one of the associated persons is limited and:

- the relevant year of income is 1995-96 year of income or a later year of income or
- the partnership was formed on or after 19 August 1992 or
- if the partnership was formed before 19 August 1992 either it does not pass the continuity of business test set out in Division 5A at s 94E or there has been a change in composition of the partnership after 19 August 1992 and no election has been made by the partners under section 94F that the partnership not be treated as a corporate limited partnership and
- the limited partnership is not a foreign hybrid limited partnership in relation to the particular year of income, a VCLP, an ESVCLP, an AFOF or a venture capital management partnership.

[2] The definition in the Income Tax Assessment Act 1936 is the same and referenced to that in the 1997 Act.

[3] A foreign hybrid limited partnership is formed outside Australia as defined ss830-(1) and (2) of ITAA97. A VCLP is a venture capital limited partnership and defined in section 118-405(2) of the 1997 Act; an ESVCLP is an early stage venture capital partnership and defined in section 118-407(4) of the 1997 Act; an AFOF is an Australian venture capital fund of funds defined in section 118-410(3) of the 1997 Act and a venture capital management partnership is defined in section 118-405(2). In all cases these types of limited partnership must have been registered under Part 2 of the *Venture Capital Act* 2002.

These rulings apply only to limited partnerships that are also corporate limited partnerships under section 94D of the Income Tax Assessment Act 1936 (Aust) and do not have identities separate from their members. That is, they will not apply to limited partnerships which are also a foreign hybrid limited partnership, VCLPs, ESVCLPs, AFOFs or venture management partnerships.

Nothing in Division 5A of the Income Tax Assessment Act 1936 (Aust) overrides the state partnership laws by recharacterising limited partnerships as companies. Division 5A simply treats a limited partnership that also meets the test for a corporate limited partnership as a company for Australian income tax purposes only. In particular, subdivision C of Division A provides that a:

- company includes a reference to a corporate limited partnership; section 94J
- partnership does not include a reference to a corporate limited partnership; section 94K
- dividend includes a reference to a distribution made by a corporate limited partnership; section 94L.

This is discussed in the explanatory memorandum, to the Taxation Laws Amendment Act (No. 6) 1992, that accompanied the introduction of subdivision C Division 5A:

> Under the existing law, limited partnerships are treated as partnerships for taxation purposes. However, the structure of a limited partnership is comparable to that of a limited liability company in that there are "limited partners" who are similar to shareholders in a company; they do not take part in the management of the business, and their liability generally is limited to the extent of their investment.
>
> Limited partners are not at risk beyond the limit of their liability. Generally, their liability is limited to their investment. They are not required to make good losses of their partnership, nor are they liable to meet the obligations of the partnership. If limited partners are treated in the same way as partners in any other partnership, however, they may benefit from distributions of losses that exceed their limited liability. Those losses could be used to reduce taxable income, and so tax paid, even though the loss is not one that exposes the partner to any risk of having to meet obligations or make good losses.
>
> State legislation enabling the formation of limited partnerships currently exists in New South Wales, Victoria, Western Australia, Queensland and Tasmania.
>
> **Explanation of proposed amendments**
>
> The Bill will amend the Principal Act to introduce taxation arrangements in new Division 5A of Part III of the Act for taxing limited partnerships ...
>
> **The object of this new Division is to ensure that limited partnerships will be treated as companies for taxation purposes. This is not confined to the payment of income tax by limited partnerships, but includes all other purposes under income tax law, including the payment of tax by partners in limited partnerships; for instance, imputation and the taxation of dividends to shareholders ...** (Emphasis added)

### Australian tax consolidated groups

The concept that limited partnerships that are corporate limited partnerships are to be treated as companies for the purpose of the Australian income tax law was reinforced with the introduction of Australia's consolidation rules. The explanatory memorandum, to the New Business Tax System (Consolidation) Act (No. 1) 2002 (Aust), makes it clear that corporate limited partnerships can also be head companies within that regime because they are sufficiently equivalent to a company for Australian income tax purposes.

> 3.29 To qualify as a head company, an entity must be a company as defined in section 995-1 of the ITAA 1997.
>
> 3.30 A corporate limited partnership will also satisfy this requirement. This is consistent with the objective of ensuring consolidated groups generally receive a tax treatment like ordinary companies because these partnerships are effectively treated as companies for income tax purposes.

The effect of becoming a head company in an Australian consolidated group is that all the income of the group is deemed to have been earned by the head company and not by the individual companies in the group: section 701 of the Income Tax Assessment Act 1997 (Aust).

## AUSTRALIAN LIMITED PARTNERSHIPS UNDER NEW ZEALAND INCOME TAX LAW

### Legislation

As these rulings focus on the ability of New Zealand partners to claim foreign tax credits for tax paid or deducted by an Australian limited partnership the key provisions in the Act are:

- the definitions of "company", "partnership", and "limited partnership" in section YA 1;
- section HG 2 which sets out that partnerships are transparent;
- section CB 35 which sets out that income arising from subpart HG is assessable income to the partner; and
- subpart LJ which sets out the rules for the allowance of credits for foreign tax paid.

These provisions are discussed below.

**Limited partnerships**

In terms of entity definitions in the Act, section YA 1 sets out the definition of a company:

Company -

(a) means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere:

(ab) does not include a partnership:

(ac) includes a listed limited partnership:

(ad) includes a foreign corporate limited partnership:

(b) includes a unit trust:

...

A listed limited partnership and a foreign corporate limited partnership are also defined in section YA 1. In essence, they are defined respectively as a New Zealand or foreign limited partnership that is listed on a recognised exchange and a foreign limited partnership that is treated as a separate entity under the non-tax laws of the country concerned.

Therefore, unless an Australian limited partnership is listed on a recognised exchange or the underlying state partnership laws give it a separate legal personality, it will not meet the definition of company in New Zealand. This is irrespective of whether or not it is treated as a corporate limited partnership for Australian income tax purposes.

Therefore Australian limited partnerships, which are not treated as companies, will be treated as partnerships for New Zealand income tax purposes. This arises from the interface between section YA 1 and section 4 of the Limited Partnerships Act 2008.

Section YA 1 defines:

- "partnership" in paragraph (d) as meaning a limited partnership; and

- "limited partnership" as including an overseas limited partnership as defined in section 4 of the Limited Partnerships Act 2008 but excluding a listed limited partnership or a foreign corporate partnership.

Section 4 of the Limited Partnerships Act 2008 defines an overseas limited partnership as:

> a partnership formed or incorporated outside New Zealand with:
>
> (a) 1 or more general partners who are liable for all of the debts and liabilities of the partnership; and

> (b) 1 or more limited partners who have only limited liability for the debts and liabilities of the partnership

That is, an Australian limited partnership that meets the definition of an "overseas limited partnership" under section 4 of the Limited Partnerships Act 2008; is not listed on a recognised exchange; and is not treated as a separate entity in Australia will be treated as a partnership under New Zealand tax law.

### Partners in limited partnerships

For partners in Australian limited partnerships that meet the definition of "partnership" in section YA 1 because they are not listed on a recognised exchange or have a separate legal personality, the tax treatment is set out in section HG 2(2):

> … for a partner in their capacity of partner of a partnership, the amount of income, tax credit, rebate, gain, expenditure, or loss that they have from a particular source, or of a particular nature, is calculated by multiplying the total income, tax credit, rebate, gain, expenditure, or loss of the partners of the partnership from the particular source or of the particular nature by the partner's partnership share in the partnership income.

"Partnership share" is defined in section YA 1 as meaning:

> for a particular right, obligation, or other property, status or thing, the share that a partner has in respect of it.

The effect of section HG 2(2) and the definition of "'partnership share" is that for partners in a partnership, their assessable income includes their "partnership share" of the partnership income. Section CB 35 also confirms that this is assessable income of the partner:

> A person who is a partner has an amount of income to the extent to which an amount of income results from the application of subpart HG (Joint venturers, partners, and partnerships) to them and their partnership.

Section HG 2(2) also makes reference to tax credits, which would include foreign tax credits, being in proportion to the partner's partnership share. This then flows into sections LJ 1 to LJ 4 (Tax credits for foreign income tax).

### Foreign tax credits

The key sections relating to foreign tax credits with respect to these rulings are sections LJ 1 to LJ 4. Sections LJ 1(1), LJ 1(2)(a), and LJ 2(1) state:

> **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 not derived from New Zealand; and

...

**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. (Emphasis added).

Therefore the key terms, in determining whether a foreign tax credit is available, are "foreign income tax" and "segment of foreign-sourced income". "Foreign income tax" is defined in section LJ 3 and reinforced by section YA 2(5) and "segment of foreign-sourced income" is defined in section LJ 4.

Section LJ 3 states that "foreign income tax" is:

> an amount that, if paid, would satisfy a person's obligations in a foreign country in relation to amounts that have the same nature as income tax.

Section YA 2(5) states that "income tax" when used in relation to foreign tax:

(a) means a tax of substantially the same nature as income tax imposed under section BB 1 (Imposition of income tax); and

(b) includes a tax, imposed as a collection mechanism for the foreign tax, that is of substantially the same nature as ... non-resident withholding tax (NRWT).

The Australian tax considered in these rulings is company tax and dividend withholding tax. In Australia, taxable income of a company is calculated under section 4-15 of Income Tax Assessment Act 1997 (Aust), the Australian core provisions, which is comparable to section BB 1 in New Zealand. Dividend withholding tax that is deducted under section 128B of the Income Tax Assessment Act 1936 (Aust), is deducted from the gross amount of dividend and is otherwise excluded from the non-resident's assessable income. This is comparable to the deduction of non-resident withholding tax from dividends in New Zealand under subpart RF of the Act.

A "segment of foreign-sourced income" is defined in section LJ 4 as:

> an amount of assessable income derived from 1 foreign country that comes from 1 source or is of 1 nature.

Therefore for a New Zealand resident partner of an Australian limited partnership to be allowed a foreign tax credit under sections LJ 1 and HG 2, three key elements must be satisfied once income has been allocated to the partner under section HG 2:

1. A person resident in New Zealand must derive assessable income from a foreign source.

2. Foreign income tax must be paid.

3. The foreign income tax paid must be in respect of that assessable income from a foreign source.

It follows that a foreign tax credit is not available where a person has not actually paid foreign income tax; the foreign income tax has been paid but it is not in respect of income that is assessable in New Zealand; or there is no assessable income calculated under New Zealand tax law. The foreign income tax could be Australian company tax or dividend withholding tax as appropriate.

**Double Tax Agreement with Australia**

In the arrangements covered by the five rulings, the application of the treaty that came into force on 19 March 2010 or the previous treaty does not result in any relief that is different from the foreign tax credits granted under domestic law, as discussed above.

**EXAMPLES**

This section of the commentary discusses the specific factual scenarios related to each of the five public rulings. In all cases they involve Australian tax being paid at some level, but the issue is whether or not the Australian tax will be available to the New Zealand partners as a foreign tax credit.

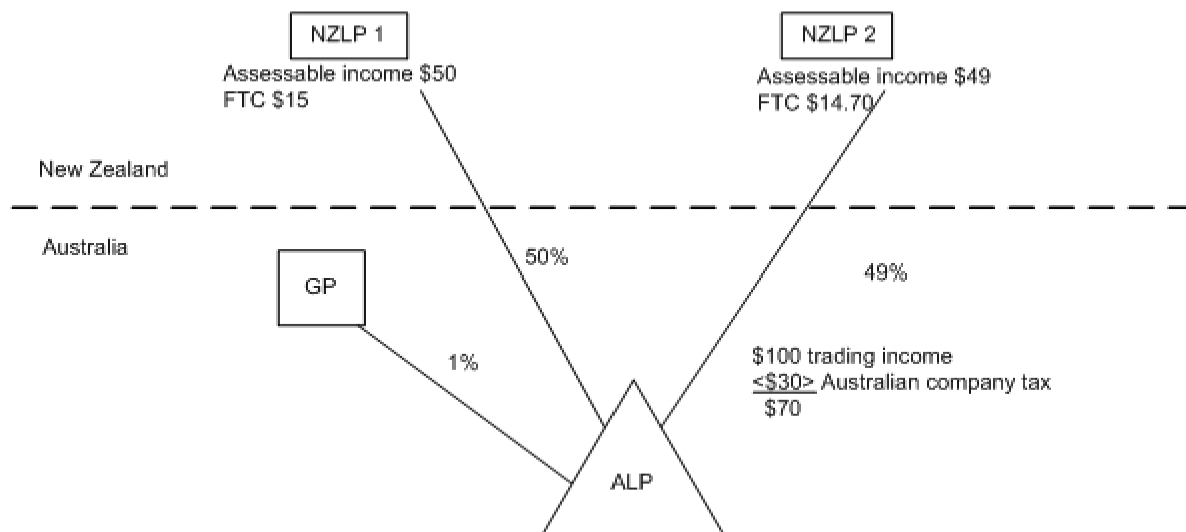
In all five examples the Australian limited partnership ("ALP") has three partners:

- one general partner ("GP") based in Australia having a 1% partnership share; and
- two New Zealand resident limited partners ("NZLP 1" and "NZLP 2") with 50% and 49% partnership shares respectively (the 50% and 49% partners). In examples one, two and five, "NZLP 1" and "NZLP 2" are either a company or a natural person but are only a natural person in examples three and four.

The Australian limited partnership is treated as a corporate limited partnership for Australian income tax law but is treated as a partnership for New Zealand income tax law.

To avoid currency exchange issues, the reference to "$" is not a reference to any particular currency; it is used simply for illustrative purposes.

**Example 1: Australian source income**




ALP earns trading income in Australia of $100 and pays Australian company tax of $30 on it.

The trading income is partnership income to the partners, so they must include their partnership share in their taxable income. The Australian company tax is allowed as a foreign tax credit ("FTC") in the same proportion as the partner's partnership share. This is because the three key elements are met:

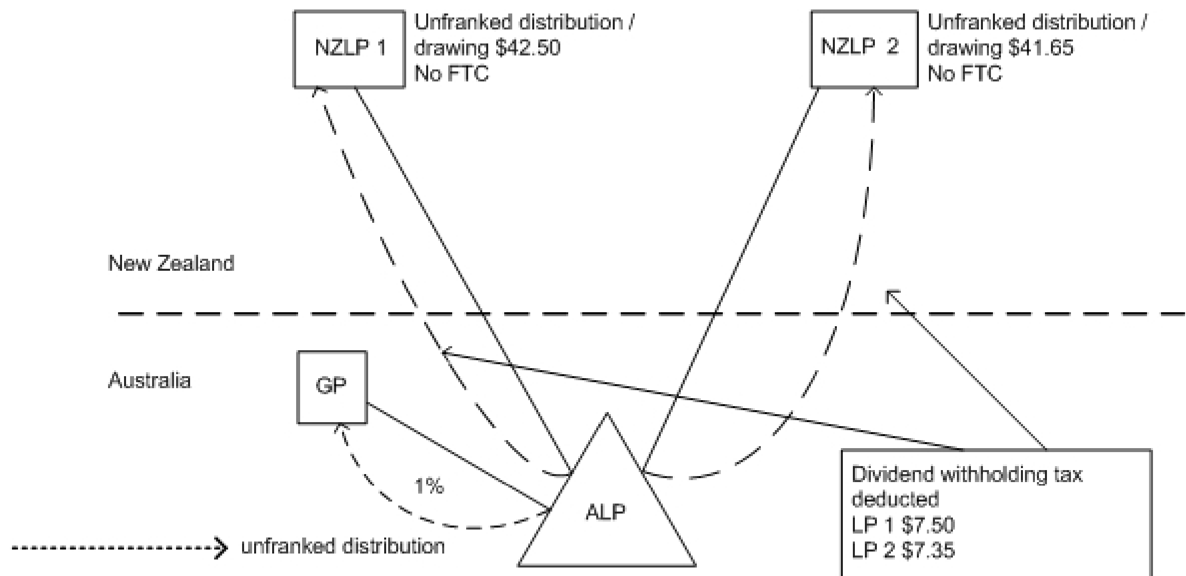
1. The partnership income is assessable to the partners under sections HG 2 and CB 35.

2. The Australian company tax was paid to the Australian Government by the ALP.

3. The Australian company tax was paid because the ALP earned trading income.

In the specific example, the 50% partner – NZLP 1 - has assessable income of $50 and a foreign tax credit of $15 and the 49% partner – NZLP 2 - has assessable income of $49 and a foreign tax credit of $14.70. This is their respective partnership share of the trading income and the Australian company tax paid.

**Example 2: Distribution made by Australian limited partnership**

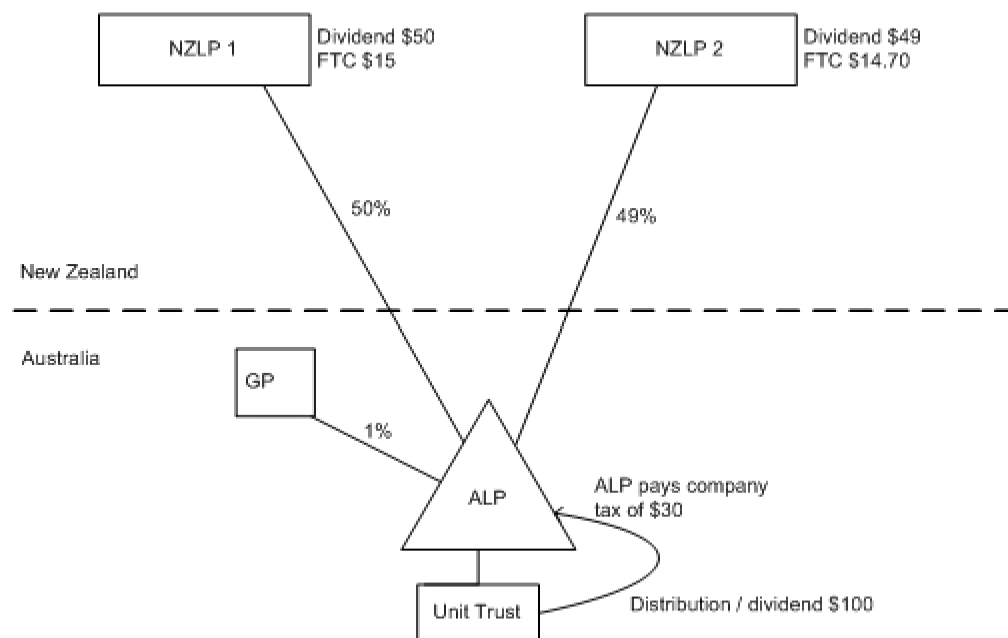



The ALP makes an unfranked distribution to the partners of $100. For Australian income tax purposes, this distribution is treated as a dividend and Australian dividend withholding tax of 15% is deducted. The net amount distributed is then $85 in total.

In this situation only the second of the three elements has been met. While the income tax – dividend withholding tax of 15% - has been paid to the Australian Government, it has not been paid in respect of New Zealand assessable income. This is because for New Zealand income tax purposes, the distribution from a partnership would have the nature of drawings and not be subject to New Zealand income tax.

Therefore, no foreign tax credit is available to the New Zealand partners.

**Example 3: Distribution made from subsidiary unit trust**




In example 3, the ALP owns a subsidiary unit trust and the New Zealand partners are natural persons. As seen previously, a unit trust is included in the definition of "company" for New Zealand income tax purposes. The unit trust distributes income of $100 to the ALP and the ALP pays company income tax on the income from the unit trust of $30.

Under New Zealand income tax law the distribution from a unit trust is a dividend under section CD 1.

In this case all three elements are met:

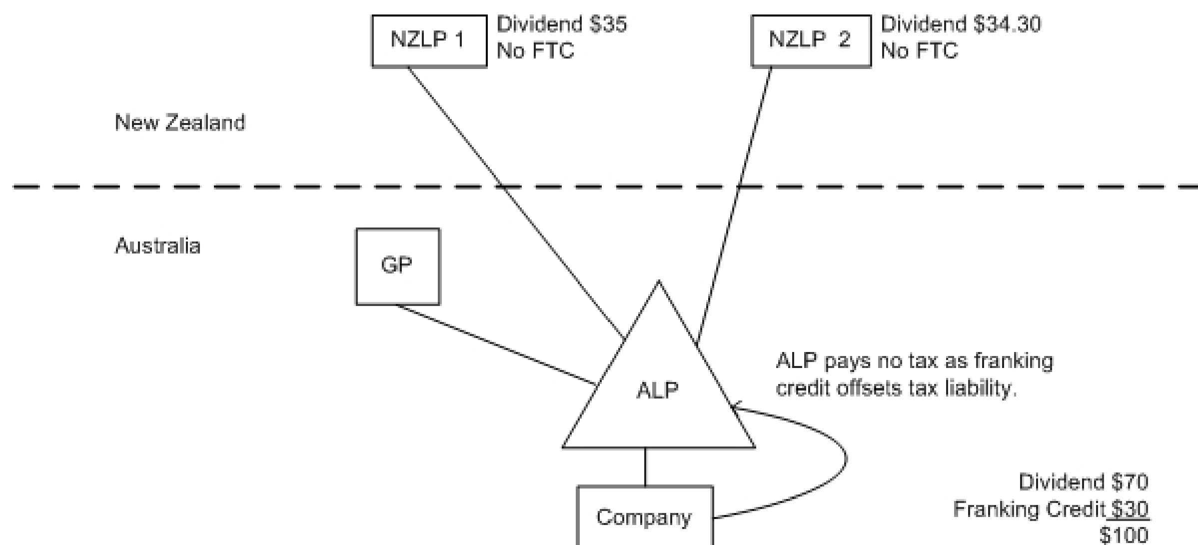
1. The dividend will be assessable income to the partners under sections CD 1 and HG 2.

2. The income tax on that dividend has been paid to the Australian Government.

3. The Australian company tax was paid because the ALP received that distribution/dividend.

Therefore a foreign tax credit will be allowed in proportion to the partner's partnership share of partnership income. This means that the 50% partner – NZLP 1- has dividend income of $50 and a foreign tax credit of $15 while the 49% partner – NZLP 2 - has dividend income of $49 and a foreign tax credit of $14.70.

**Example 4: Franked dividend received by Australian limited partnership**




The ALP owns a subsidiary company that pays a $70 franked dividend to it and the New Zealand partners are natural persons. The underlying basis of the franking credit was company tax the subsidiary company had paid previously on its trading income. While the dividends received by the ALP are subject to tax in Australia, the attached franking credit means that the ALP does not pay tax on that income as the franking credit offsets any tax liability on the dividend.

In this case only the first and the second of the three elements are met:

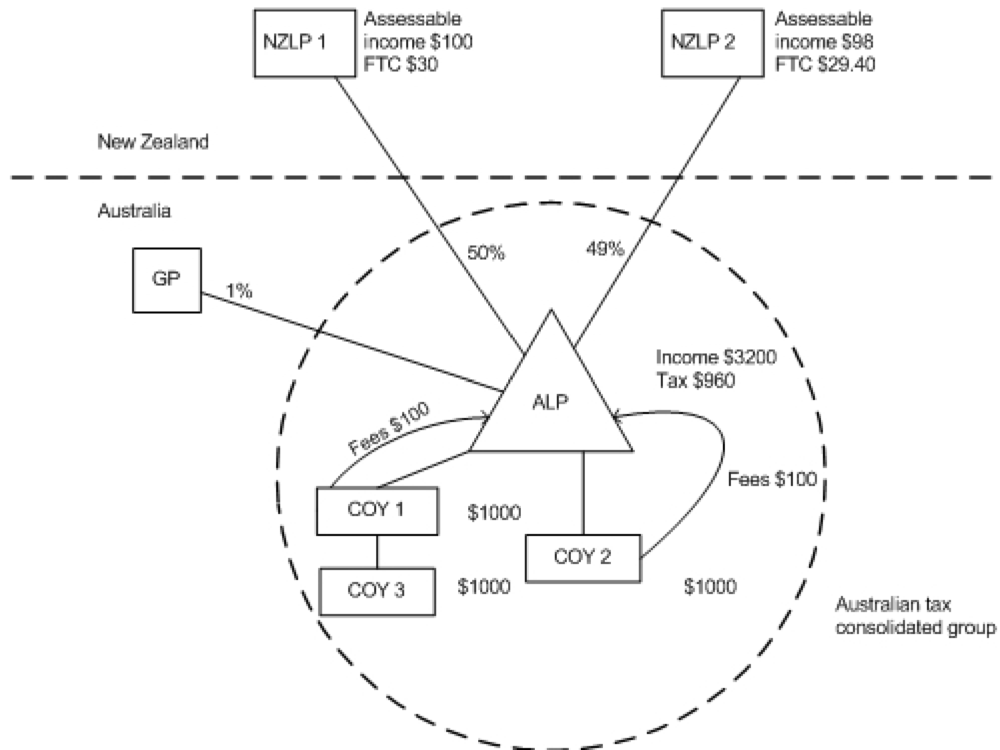
1. The dividend will be assessable income to the partners under sections CD 1 and HG 2(2).

2. Income tax was paid to the Australian Government by the subsidiary company on its trading profits.

3. However, this income tax was not paid because the ALP received a dividend and so the franking credit is not available as a foreign tax credit for the New Zealand partners, as is the general case with franking credits attached to Australian dividends. Therefore, no foreign tax credit is available to the New Zealand partners.

In terms of New Zealand assessable income, however, there is dividend income of $35 and $34.30 to the 50% partner and 49% partner respectively.

**Example 5: Tax paid by Australian limited partnership as "head company" of an Australian tax consolidated group**




The ALP as the head company for a consolidated group of companies (COY1, COY2 and COY3) pays tax on all the taxable income of the consolidated group in Australia. The taxable income of the consolidated group is $3,200 and the company tax paid is $960. This includes income from subsidiary companies that is not earned by the ALP of $3,000 which is calculated after allowing for the fees paid to the ALP. The New Zealand partners' partnership share of the partnership income does not include any part of the income that is not earned by the ALP and includes only their partnership share of the $200 earned directly by the ALP. That is, $100 and $98 for the 50% partner and 49% partner respectively.

In this case, the three elements are met and a foreign tax credit will be available to the partners of the ALP but only to the extent that the tax paid relates to income that is subject to tax in New Zealand.

A foreign tax credit potentially will be available only for the Australian company tax paid on the income earned directly by the ALP; that is $60 being the company tax on $200. In this case the foreign tax credit of $30 will be allowed to the 50% partner – NZLP 1 - and $29.40 to the 49% partner – NZLP 2.