

PUBLIC RULING BR PUB 20/01: Dividends derived by New Zealand resident investor in a United States limited liability company that is a foreign investment fund where the NZ investor holds foreign investment fund interests of \$50,000 or less

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CQ 5(1)(d), EX 28, LJ 1(1) and LJ 2(1) and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ-US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Non-attributing FIF interest means a FIF where the New Zealand investor's attributing interests in all FIFs is \$50,000 or less throughout the year under s CQ 5(1)(d).

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC which has not made an election to be taxed as a corporation.
- The NZ investor is a natural person who is not a transitional resident and is not acting as a trustee other than as a trustee that meets the requirements of section CQ 5(1)(e).
- The US LLC investment is a non-attributing FIF interest for the NZ investor and is not an interest in a controlled foreign company.
- The circumstances in s CQ 5(1)(d)(ii) and (iii) do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is paid on the distribution from the US LLC to the NZ investor.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

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

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The distribution from the US LLC to the NZ investor will be a dividend under s CD 1.
- The NZ investor is not required to attribute income under s CQ 5(1)(d).
- The NZ investor may claim a deduction for US federal income tax on their US LLC income against any dividend derived from the US LLC under s CD 18.
- The NZ investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it, any refund and the amounts of such tax previously deducted, from dividends derived under the formula in s CD 18(2).
- The NZ investor cannot claim a New Zealand foreign tax credit (under ss LJ 1(1) and LJ 2(1) or the NZ-US DTA) for US federal income tax paid on partnership income against their New Zealand tax liability on dividends derived from the US LLC.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of this Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.



Susan Price
Group Leader, Tax Counsel Office

PUBLIC RULING BR PUB 20/02: Foreign investment fund income derived by a New Zealand resident investor in a United States limited liability company

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CD 36, CQ 4, CQ 5, CX 57B, EX 44, EX 28, EX 51(1), EX 51(6)(b), EX 59(2), LJ 1(1) and LJ 2(1) and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not elected to be taxed as a corporation and is a FIF.
- Where the NZ investor is a natural person, the cost of their interest in the FIF is greater than \$50,000 in a year and they are not a transitional resident.

- The NZ investor adopts one of the following FIF income calculation methods: the fair dividend rate, comparative value, cost method or deemed rate of return.
- The exemptions from holding an attributing interest in a FIF set out in ss EX 31 to EX 43 do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is payable on the distribution from the US LLC to the NZ investor.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

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

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will be subject to tax on their FIF income as calculated by applying one of the FIF calculation methods (the fair dividend rate, comparative value, cost method or deemed rate of return) under ss CQ 4, CQ 5 and EX 44.
- If the NZ investor uses the comparative value FIF method they may deduct US federal income tax paid in the income year on the partnership income as a cost under s EX 51(6)(b), when calculating their FIF income under the formula in s EX 51(1). It is also a gain in that formula, but this is offset by the US tax payment reducing the closing value in the formula.
- Any amount derived by the NZ investor from their interest in the FIF (other than FIF income) is excluded income under ss EX 59(2) and CX 57B.
- A distribution paid to the NZ investor by the US LLC is not treated as a dividend for New Zealand tax purposes under s CD 36.
- Section CD 18 does not apply because the distribution from the US LLC to the NZ investor is deemed not to be a dividend under s CD 36.

The NZ investor cannot claim a New Zealand foreign tax credit (under ss LJ 1(1) and LJ 2(1) or the NZ-US DTA) for US federal income tax paid on partnership income against their New Zealand tax liability on FIF income.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of this Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.



Susan Price

Group Leader, Tax Counsel Office

PUBLIC RULING BR PUB 20/03: Attributed foreign investment fund income derived by a New Zealand resident investor in a United States limited liability company

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CQ 4, CQ 5, CW 9, EX 44(1)(b), EX 28, EX 50, LK 1(1)(d), OE 1(2) and OE 20 and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not made an election to be taxed as a corporation and is a FIF.
- Where the NZ investor is a natural person, they are not a transitional resident, and the cost of their interest in the FIF is greater than \$50,000 in a year.

- The NZ investor adopts the attributed FIF income method for calculating FIF income.
- The exemptions from holding an attributing interest in a FIF set out in ss EX 31 to EX 43 do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is payable on the distribution from the US LLC to the NZ investor.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

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

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will be subject to New Zealand tax on the attributed income from their interest in the FIF under ss CQ 4, CQ 5, EX 44(1)(b) and EX 50.
- US federal income tax paid for the NZ investor on their US partnership income is creditable against the NZ investor's FIF attributed income tax liability under s LK 1(1)(d). However, this is only to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and the foreign tax credits do not relate to any foreign tax paid on any active income of the FIF.
- The distribution from the US LLC to the NZ investor will be a dividend under section CD 1.
- Where the NZ investor is a company, any dividends derived by the company from a foreign company are exempt income under s CW 9 unless ss CW 9(2) or (3) apply.
- Where the NZ investor is a natural person, they will be taxed on any dividend derived from the US LLC under s CD 1. This individual NZ investor may deduct any US federal income tax paid on their partnership income from any dividend derived from the US LLC under s CD 18.
- Under the formula in s CD 18(2), the NZ individual investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it as well as any refund of US tax received and the amounts of such tax previously deducted under the formula.
- An individual NZ investor may choose to be a branch equivalent tax account person under s OE 1(2). If the individual investor has a New Zealand tax liability on their attributed FIF income (after claiming a foreign tax credit), then the individual NZ investor may claim a branch equivalent tax account tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of the Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.



Susan Price
Group Leader, Tax Counsel Office

PUBLIC RULING BR PUB 20/04: Controlled foreign corporation income derived by a New Zealand resident investor in a United States limited liability company

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CQ 1, CQ 2, CW 9, EX 1, LK 1(1)(d), OE 1(2) and OE 20 and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Controlled foreign corporation (CFC) means a controlled foreign corporation as defined in s EX 1.

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ-US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not elected to be taxed as a corporation and their interest is in a CFC.
- Where the NZ investor is a natural person, they are not a transitional resident.
- The US LLC makes a distribution to the NZ investor.

- The US LLC withholds and pays US federal income tax on the NZ investor's share of partnership income.
- No US federal income tax is payable on the distribution from the US LLC.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

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

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will be subject New Zealand tax on the attributed income from their interest in the CFC under ss CQ 1 and CQ 2.
- US federal income tax paid for the NZ investor on their US partnership income is creditable against the NZ investor's CFC attributed income tax liability in terms of section LK 1(1)(d). However, this is only to the extent that it does not exceed the New Zealand tax payable on the CFC attributed income and the foreign tax credits do not relate to any foreign tax paid on any active income of the CFC.
- The distribution from the US LLC to the NZ investor who is not a company will be a dividend under s CD 1.
- Where the NZ investor is a company, any dividends derived by the company from a foreign company are exempt under s CW 9 unless ss CW 9(2) or (3) apply.
- Where the NZ investor is a natural person, they will be taxed on any dividend derived from the US LLC under s CD 1. This individual NZ investor may deduct any US federal income tax paid on their partnership income from any dividend derived from the US LLC under s CD 18.
- Under the formula in s CD 18(2), the individual NZ investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it, as well as any refunds of US tax received and the amounts of such tax previously deducted under the formula.
- An individual NZ investor may choose to be a branch equivalent tax account person under s OE 1(2). If the individual investor has a New Zealand tax liability on their attributed CFC income (after claiming foreign tax credits), then the individual investor may claim a branch equivalent tax account tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of the Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.



Susan Price
Group Leader, Tax Counsel Office

PUBLIC RULING BR PUB 20/05: Dividends derived by a New Zealand resident investor in a United States limited liability company that is either a non-attributing active foreign investment fund or a controlled foreign corporation

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CW 9, CQ 2(1)(h), CQ 5(1)(c)(xv), EX 1, EX 28, LJ 1(1) and LJ 2(1) and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

- **Controlled foreign corporation (CFC)** means a controlled foreign corporation as defined in s EX 1.
- **Distribution** means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.
- **Dividend** means a dividend as defined in s CD 3.
- **Foreign investment fund (FIF)** means a foreign investment fund as defined in s EX 28.
- **Managing Members** means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.
- **Member** means a person who has an ownership interest in a US LLC.
- **New Zealand – United States Double Tax Agreement (NZ-US DTA)** means the agreement under the Double Taxation Relief (United States of America) Order 1983.
- **Non-attributing active FIF or non-attributing active CFC** means a FIF (adopting the attributed foreign investment fund income method and where the NZ investor's interest in the FIF is an exempt non-attributing active FIF interest under s CQ 5(1)(c)(xv)) or a non-attributing active CFC under ss CQ 2(1)(h) and EX 21B.
- **Partnership income** means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

- **United States limited liability company (US LLC)** means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not elected to be taxed as a corporation and their interest is in a non-attributing active FIF or a non-attributing active CFC.
- Where the NZ investor is a natural person, they are not a transitional resident and the exemptions set out in ss EX 31 to EX 43 do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is payable on the distribution from the US LLC.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

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

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will not have attributed income for either FIF or CFC purposes under ss CQ 5(1)(c)(xv) or CQ 2(1)(h) respectively.
- The distribution from the US LLC to a NZ investor who is not a company will be a dividend under s CD 1.
- Where the NZ investor is a company, any dividends derived by the company from a foreign company are exempt income under s CW 9 unless ss CW 9(2) or (3) apply.
- Where the NZ investor is a natural person, they will be taxed on any dividend derived from the US LLC under s CD 1. This individual NZ investor can deduct any US federal income tax paid on their partnership income from any dividend derived from the US LLC under s CD 18.
- Under the formula in s CD 18(2), the individual NZ investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it, as well as any US tax refunds received and the amounts of such tax previously deducted under the formula.
- The NZ investor cannot claim a New Zealand foreign tax credit (under ss LJ 1(1) and LJ 2(1) or the NZ-US DTA) for US federal income tax on partnership income against their New Zealand tax liability on dividend income derived from the US LLC.
- As no FIF or CFC income is attributed for the income year, no branch equivalent tax account credit is available for that year.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of the Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.



Susan Price
Group Leader, Tax Counsel Office

COMMENTARY ON PUBLIC RULINGS BR PUB 20/01 to 20/05

This commentary is not a legally binding statement.

This commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 20/01 to 20/05 (the Rulings).

Legislative references are to the Income Tax Act 2007, unless otherwise stated.

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Summary

1. A United States limited liability company (US LLC) is a hybrid entity formed in the US that has company and partnership characteristics. A US LLC is a company formed by members to hold business assets and conduct a specific business and provides limited liability to its members. These Rulings are focused on US LLCs that are treated as a partnership, where its members are taxed as partners for US federal income tax purposes.
2. For New Zealand tax purposes, a US LLC is a company and is a separate legal entity from its members. As a US LLC owns the business assets and conducts the specific business, the US LLC is treated as deriving the income that it earns from the conduct of that business for New Zealand tax purposes. Although a US LLC has partnership characteristics, a US LLC does not meet the New Zealand legal requirements for being taxed as a partnership.
3. This commentary explains the circumstances when a foreign tax credit (FTC) or other relief is available to a New Zealand investor in a US LLC for US federal income tax paid by them on their “distributive share”¹ of the US LLC’s income. This depends on whether the US LLC is a foreign investment fund (FIF) or a controlled foreign corporation (CFC), and if the US LLC pays a dividend to the New Zealand investor.
4. A New Zealand investor is entitled to claim a New Zealand FTC for US federal income tax paid by them and/or “relief” in terms of s CD 18 or s EX 51 in the three circumstances set out in the Rulings.
5. The first circumstance is where the US LLC is a CFC or a FIF (and the investor adopts the attributable FIF income method) and the New Zealand investor has attributed CFC or FIF income. The New Zealand investor may claim a FTC for any US federal income tax they pay on their distributive share of the US LLC’s income against their New Zealand tax liability on attributed CFC or FIF income.
6. The second circumstance is where the New Zealand investor derives a dividend from the US LLC. The New Zealand investor may deduct any US federal income tax they paid on their distributive share of the US LLC’s income from that dividend under s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend amount. Where the New Zealand investor is not subject to New Zealand

¹ A defined term in the US tax code in relation to partnership taxation (see 26 U.S. Code § 704).

tax on the dividend from the US LLC, then the relief provided by s CD 18 does not apply because the dividend is not taxable. This will be the case if the New Zealand investor is a company, because foreign dividends derived by a company are exempt income under s CW 9, and where the New Zealand investor adopts one of the following FIF income calculation methods: fair dividend rate, comparative value, cost method or deemed rate of return.

7. The third circumstance is where the New Zealand investor adopts the comparative value method for their FIF income and includes US federal income tax paid on their distributive share of US LLC income as a cost, a gain and as a reduction of the closing value in the formula in s EX 51(1).
8. A New Zealand investor may also be entitled to relief under the New Zealand–US double tax agreement (NZ–US DTA).² However, under the specific facts of the arrangements covered by these Rulings, the specific articles in the NZ–US DTA dealing with relief from double taxation do not apply.
9. This commentary is divided into four main areas where we discuss:
 - (a) What is a US LLC (from [11]);
 - (b) the characteristics of a US LLC that make it a company for New Zealand tax purposes (from [21]);
 - (c) why a US LLC is not a partnership for New Zealand tax purposes (from [26]); and
 - (d) why a US LLC is treated for New Zealand tax purposes as deriving the income that it earns from the conduct of the US LLC’s business (from [29]).
10. Explanatory examples are included from [136]. Abbreviations are listed in the references at the end of the commentary. An Appendix after the references sets out in flow charts how to work out which ruling applies, an overview of the tax treatment of income derived, and then tables of the tax treatment for FIFs and CFCs.

What is a US LLC?

11. A US LLC is a hybrid legal entity that is a limited liability company but also has characteristics of a partnership.³ US LLCs are established at the state level under local state law but are similar in structure across the US.
12. US LLCs have four common features:
 - (a) The US LLC is a separate legal entity from its members.

² Double Taxation Relief (United States of America) Order 1983.

³ LLCs with 2 or more members are taxed as partnerships by default unless an election is made to be taxed as a corporation. Single member LLCs are taxed on a flow through basis to that member. When a US LLC is treated as a partnership the members are taxed as partners for federal income tax purposes. The allocation of profits or losses of a US LLC must be made in accordance with the US LLC’s limited liability agreement (also known as the US LLC’s operating agreement). See, for example, § 18-503 of the 2014 Delaware Code. The allocation of the US LLC’s profits to its members and the crediting to their capital account is similar to how profits are allocated and accounted for in a partnership.

- (b) The business of the US LLC is conducted by the US LLC and not its members.
 - (c) The assets used for carrying on the business of the US LLC are owned by the US LLC and not by its members.
 - (d) The US LLC is liable for the debts incurred as a result of carrying on the US LLC's business. The members have no liability for the liabilities of the US LLC.
13. The operations of a US LLC are generally governed by an operating agreement. Most operating agreements include an explanation of:
- (a) each member's percentage interest in the US LLC represented by their capital account;
 - (b) the members' rights and responsibilities;
 - (c) how the US LLC will be managed;
 - (d) dissolution procedures;
 - (e) how profits and losses for financial accounting and tax are to be allocated to each member; and
 - (f) rules governing what distribution of a member's share of the US LLC's profits is to be made in a particular year.
14. A US LLC is managed by its members or a manager. A manager may be a group of members (Managing Members) or a third party.
15. Ownership in a US LLC is represented by a membership interest rather than by shares. Therefore, a US LLC's owners are referred to as members rather than shareholders.
16. Generally, profits are allocated to members in proportion to their membership interests as reflected in their capital accounts. However, the operating agreement may specify profit interests for members that are not based on their capital accounts. This mirrors partnerships that may include differential profit-sharing arrangements for members to reflect risk and reward.
17. The distributive share of the US LLC's income on which a member pays US tax is their share of the profits as determined by the operating agreement adjusted, as necessary, to meet the US tax requirements. As such, it may differ from a proportional share of the net accounting income or the specified profit share, as the case maybe.
18. A member's capital account is essentially a measure of a member's equity in a US LLC. It is generally added to by contributions the member has made and by the member's share of profits. The capital account is debited by any share of loss and by any distributions taken by the member.

19. For US federal income tax purposes, a US LLC with multiple members is treated and taxed as a partnership unless an election is made to be taxed as a corporation.⁴ Each member of a US LLC pays tax on their distributive share of the US LLC's income, which is reported on the member's individual US federal income tax return.⁵ The US LLC files a federal partnership return, and the individual member must include their distributive share in their personal federal income tax return.⁶
20. A US LLC is required to withhold tax from US sourced profits allocated to non-resident members. Different rates apply depending on the income category but commonly 30% is withheld. Since a member has already paid tax on their share of the US LLC's taxable income, the member generally pays no further US tax when the US LLC distributes that income to them. However, further US tax would be payable if, for example, the member was distributed an amount in excess of their capital account. When a member files their US tax return they may receive a refund of US tax, for example, if the NZ-US DTA reduces the applicable rate on the type of income from that withheld by the US LLC.

Characteristics of a US LLC that make it a company for New Zealand tax purposes

21. The word "company" is defined in s YA 1. Company (in part):
 - (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:
22. In S Watson and L Taylor (eds), *Corporate Law in New Zealand* (online ed, Thomson Reuters, 2019), the authors note the attributes of the modern New Zealand company in the following terms (at [16.1.2]):

As a species of corporation, the modern company has the following traditional and modern corporate attributes:

 - (1) It has perpetual succession. Until dissolved, a company continues to exist and survives the death of its directors and shareholders.
 - (2) It owns its property. The assets of a company do not belong to the shareholders. The only interest which they have in the assets of the company is indirectly through the medium of their shares. They have no proprietary rights to the underlying assets. Similarly, creditors of the company are not creditors of the shareholders. The creditors must claim against the company, and it is only if the company is in liquidation and there is some evidence of use of the corporate form to evade obligations that claimants may possibly have recourse against the shareholders.
 - (3) As a separate legal person, the company can transact and can sue or be sued in its own name.

⁴ *Taxation of Limited Liability Companies* (Publication 3402, Internal Revenue Service, Washington, 2016) provides that a US LLC with at least two members is classified as a partnership for federal income tax purposes.

⁵ The US Internal Revenue Code, § 701, states that partners are liable to tax and not the partnership. Each member must file an annual federal income tax return.

⁶ As the US LLC is classified as a partnership for federal income tax purposes, the US LLC must file a federal partnership return reporting the taxable income of the partnership computed in terms of § 703 of the Internal Revenue Code (US). However, it is the partners who are liable to income tax and not the partnership: § 701 of the Internal Revenue Code (US).

- (4) The liability of the shareholders of a limited company is usually limited. Shareholders are only liable for the amount unpaid on their shares.
 - (5) As a consequence of limited liability, the capital of the company is locked in creating entity partitioning or strong form entity shielding.
 - (6) As the price of incorporation, the company must comply with the formalities of the Act. This requires payment of the registration fee, and the regular filing of documents and accounts with the Registrar of Companies. These are the costs of transacting business in this particular way.
23. A US LLC meets the definition of a company for New Zealand company and tax law purposes for six main reasons:
 - (a) A US LLC is a legal entity that comes into existence by the execution of a certificate of formation.⁷ It remains in existence until it is dissolved.
 - (a) The assets used for carrying on the business of the US LLC belong to the US LLC and not its members.⁸
 - (b) The US LLC (and not the members) is liable for the debts incurred as a result of carrying on the US LLC's business. The members have no liability for the liabilities of the US LLC.
 - (c) The liability of a member of a US LLC is limited to their capital contributions as defined in the US LLC's operating agreement or, where there is no operating agreement, under state law.⁹
 - (d) A US LLC's operating agreement generally specifies how a US LLC will be dissolved and how assets will be allocated to members. In a US LLC, initial capital and retained profits are largely locked in.
 - (e) Fees and formalities need to be paid and satisfied to create a US LLC in the US.
24. Alternatively, a US LLC could be an "other entity that has a legal existence separate from that of its members, whether incorporated or created in New Zealand or elsewhere".
25. A US LLC is an entity that has a separate legal existence from its members and is incorporated or created in the US.

Why a US LLC is not a partnership for New Zealand tax purposes

26. Section YA 1 provides that a company does not include a partnership.
27. A "partnership" is defined in s YA 1 to mean a partnership as described in s 4(1) of the Partnership Act 1908. Section 4 of the Partnership Act 1908 defines a partnership as the relationship that "subsists between persons carrying on a business in common with a view to profit".

⁷ For example, § 18-201 of the LLC Act (Delaware) provides that a company formed under that Act is a separate legal entity until the cancellation of the company's certificate of formation.

⁸ For example, § 18-701 of the LLC Act (Delaware) provides that members have no interest in specific property of the LLC.

⁹ For example, § 18-502 of the LLC Act (Delaware) states that a member is obligated to an LLC to make their promised cash, property or service contributions.

28. A US LLC is not a partnership for New Zealand tax purposes because it is the US LLC that carries on the business and not the members of the US LLC.

Why a US LLC is treated for New Zealand tax purposes as deriving the income it earns from the conduct of the US LLC's business

29. A company is a separate legal entity and, for New Zealand tax purposes, is a separate taxpayer from its shareholders. Where a taxpayer owns business assets and carries on a business, then the income from that business is derived by that taxpayer. Section CB 1 states that "an amount that a person derives from a business is income of the person".
30. Although in the context of the Rulings, the US LLC is not a New Zealand taxpayer, the scheme of the Act, as far as business owners are concerned, applies to a US LLC. Accordingly, a US LLC that is a separate legal entity and owns the assets and conducts the business of the US LLC, will be treated as deriving any income it earns from the business activities conducted by it for New Zealand tax purposes (that is, the income will not be treated as derived by the members of the US LLC).
31. Consequently, a New Zealand investor in a US LLC will be subject to New Zealand tax on dividends derived from the US LLC and/or any FIF income or attributed CFC income, where the US LLC is a FIF or a CFC. The New Zealand income tax consequences for a New Zealand investor in a US LLC are discussed next.

How a New Zealand resident investor is taxed on income derived from a US LLC

32. A New Zealand investor in a US LLC will be subject to New Zealand tax on dividends derived from the US LLC and/or any FIF income or attributed CFC income, where the US LLC is a FIF or a CFC.
33. In the following paragraphs, we discuss:
- (a) what a dividend is for New Zealand tax purposes (from [34]);
 - (b) when a dividend is derived for New Zealand tax purposes (from [39]);
 - (c) what is a dividend in the US LLC context (from [40]);
 - (d) the application of the FIF regime to investments in a US LLC (from [49]); and
 - (e) the application of the CFC regime to investments in a US LLC (from [73]).

What a dividend is for New Zealand tax purposes

34. Section CD 1 states that a "dividend derived by a person is income of the person". Section CD 3 provides that ss CD 4 to CD 20 define what a dividend is.
35. Section CD 4(1) provides:

CD 4 Transfers of company value generally

Transfers of company value from company

- (1) A transfer of company value from a company to a person is a dividend if—

- (a) the cause of the transfer is a shareholding in the company, as described in section CD 6; and
- (b) none of the exclusions in sections CD 22 to CD 37 applies to the transfer.

36. Section CD 5(1) provides:

CD 5 What is a transfer of company value?

General test

- (1) A **transfer of company value** from a company to a person occurs when—
 - (a) the company provides money or money’s worth to the person; and
 - (b) if the person provides any money or money’s worth to the company under the same arrangement, the market value of what the company provides is more than the market value of what the person provides.

37. Section CD 6(1) expands on s CD 5(1):

CD 6 When is a transfer caused by a shareholding relationship?

General test

- (1) A transfer of company value from a company to a person (the **recipient**) is caused by a shareholding in the company if—
 - (a) the recipient at any relevant time—
 - (i) holds shares in the company; or
 - (ii) is associated with a shareholder; and
 - (iii) *[Repealed]*
 - (b) the company makes the transfer because of that shareholding of the relevant shareholder.

38. In summary, a dividend is a transfer of company value (the provision of money or money’s worth) to a person from a company where that transfer in value is because of that person’s shareholding (for example, the payment of a dividend to a shareholder in a publicly held company).

When a dividend is derived for New Zealand tax purposes

39. A dividend is not income of a person unless it is also derived by that person for New Zealand tax purposes. The arrangements to which these Rulings apply assume that the New Zealand investor is a cash-basis or an accruals-basis taxpayer. A dividend is derived for both types of taxpayers when the income is credited to the taxpayer’s account or in some other way dealt with in their interest or on their behalf, even if it is not treated as derived by them under common law: s BD 3(4).

What a dividend is in the US LLC context

40. A US LLC’s operating agreement will specify how the annual net accounting profits or losses of the US LLC are allocated to its members and any profit sharing arrangements that depart from a member’s percentage ownership interest .¹⁰

¹⁰ Where there is no term in the operating agreement or no operating agreement, then, generally, the US state law on which the US LLC was created will contain a default rule for the allocation of accounting profits or losses to its members. For example, § 18-503 of the 2014 Delaware Code

Generally, a proportional share of net profits or losses or the specified profit share are credited or debited to a member's capital account, and any subsequent distribution is debited to the member's capital account.

41. A US LLC's operating agreement will also contain rules for when amounts in a member's capital account will be distributed or held in reserve to meet expected or contingent liabilities.
42. The allocation and crediting to a member's capital account of the member's share of the US LLC's profits is a "dividend" as defined in ss CD 4 and CD 5 for New Zealand tax purposes, as it is a transfer of value (the provision of money or money's worth) by the US LLC to a member and the cause of transfer is the member's "shareholding" in the US LLC.
43. A dividend will be derived by a member when the member has a right to access their share of profits credited to their capital account. This will commonly coincide with the Managing Members of the US LLC (or other person authorised to make that decision) resolving to distribute funds to a member and when the funds are placed outside the control of the Managing Members.
44. The time when funds are placed outside the control of the Managing Members depends on the rules relating to distributions in a particular US LLC's operating agreement. For example, where distributions to a member from the member's capital account are at the sole discretion of the Managing Members (or those authorised to make the decision), then the dividend will be derived by a member at the time the Managing Members resolve to make a distribution to a member and the member can access the funds. In these circumstances, the Managing Members have formally parted with control of the funds, and the member can access those funds as they wish.
45. On the other hand, where a member of a US LLC is able to withdraw their share of the US LLC's profits from their capital account (subject to cash being available) because the US LLC's operating agreement provides for mandatory distributions, then the dividend will be derived for New Zealand tax purposes at the time of crediting to the member's capital account. Examples 1 and 2 explain the practical effects of this difference (the examples start at [136]).
46. The Commissioner's approach is consistent with the High Court decision in *CIR v Albany Food Warehouse* (2009) 24 NZTC 23,532. The court in *Albany* was required to consider when amounts credited to a shareholder's current account should be treated as paid to them for New Zealand tax purposes. The court concluded the amount was paid if it was placed outside the directors' control as a result of the directors' resolution declaring the dividend and crediting the dividend to the shareholder's current account. The court distinguished the facts of *Albany* with those in *Alliance Group Ltd v CIR* (1995) 17 NZTC 12,066 where the High Court had concluded that there had not been a payment at the time of crediting to the account of the taxpayer, because the taxpayer did not have the right to draw on the funds in the account.
47. The Rulings assume that distributions from a member's capital account are at the sole discretion of the Managing Members, and that a member will be able to access funds in their capital account only once the Managing Members have resolved to

provides that in the absence of a term in the operating agreement, profits or losses should be allocated on the basis of the agreed value of the contributions made by each member.

distribute the funds. In such circumstances, a dividend will be derived for New Zealand tax purposes by a member at the time of distribution to that member.

48. The circumstances, and how a dividend derived by a New Zealand investor in a US LLC will be taxed, depends also on whether the US LLC is a FIF or a CFC. The application of the FIF and CFC rules, s CD 18 and New Zealand's FTC rules are discussed next.

Application of the FIF regime to investments in a US LLC

49. An investment in a US LLC by a New Zealand investor will be an investment in a FIF (unless it is a CFC) and the FIF rules will apply.
50. Section EX 28 defines a FIF as including a "foreign company". As discussed earlier, s YA 1 defines a "company" to include a body corporate or other entity that has a legal existence separate from its members, whether incorporated or created in New Zealand or elsewhere. Section YA 1 in turn defines a "foreign company" as a company that is not resident in New Zealand. A US LLC is a company for New Zealand tax purposes, and it is assumed that for the purposes of these Rulings the US LLC is not tax resident in New Zealand.
51. A New Zealand investor in a US LLC that is a FIF will be subject to tax on FIF income if they hold an "attributing interest" in the FIF as described in s EX 29 and none of the FIF exemptions in ss EX 31 to EX 43 apply. One category of attributing interest that is relevant to an interest in a US LLC is a direct income interest as described in s EX 30(1):

EX 30 Direct income interests in FIFs

Categories of direct income interest

- (1) A person has a direct income interest in a foreign company at any time if they hold—
- (a) any of the shares in the foreign company;
 - (b) any of the shareholder decision-making rights for the company;
 - (c) a right to receive, or to apply, any of the income of the company for the accounting period in which the time falls;
 - (d) a right to receive, or to apply, any of the value of the net assets of the company, if they are distributed.
52. Shares in a foreign company are a direct income interest: s EX 30(1)(a). A "share" is defined in s YA 1 to "include any interest in the capital of a company". A member's ownership in a US LLC is represented by their membership interest in the LLC (generally in proportion to their capital contributions to the LLC) rather than shares. A member's capital account generally includes initial capital, any additional capital and the allocation of the net accounting profits or losses of the US LLC to its members less distributions made. A member's interest of a US LLC in their capital account is considered an "interest in the capital of the company" and is a "share" for New Zealand tax purposes.
53. A right to receive, or to apply, any of the income of a foreign company for an accounting period in which the time falls is also a direct income interest: s EX 30(1)(c). A US LLC operating agreement may specify a profit interest of each member. In these circumstances, the percentage of a US LLC's profits allocated to a member's capital account is based on the profit interest specified in the operating agreement rather than based on the member's capital interest that is reflected by

their capital account balance relative to the total capital of the US LLC. A member's profit interest in a US LLC is considered a "right to receive, or to apply, any of the income of a foreign company for an accounting period in which the time falls" for New Zealand tax purposes.

54. In summary, a member's interest or profit interest in a US LLC can be a direct income interest, so is an attributing interest in a FIF. In these circumstances, a New Zealand investor who is a member of a US LLC will be subject to tax on FIF income (subject to exemptions). It is assumed for the purposes of the Rulings that none of the FIF exemptions in ss EX 31 to EX 43 apply. Similarly, it is assumed that the member is not a transitional resident who is not taxed in New Zealand on certain foreign-sourced income.
55. The FIF rules apply to the following arrangements, as set out in the Rulings.

Where the cost of the New Zealand investor's interests in FIFs is \$50,000 or less

56. A natural person and trustees for a limited variety of trusts holding an interest in a FIF will not have FIF income if the cost of the FIF interests they hold does not exceed \$50,000 at any time in a year: s CQ 5(1)(d).¹¹ This assumes the person has not opted to include FIF income despite their FIF interests being less than the threshold. The New Zealand investor will be taxed on only the actual dividends derived from the US LLC (and from any other FIF interests they hold) under s CD 1 and is not required to calculate income under the FIF rules under s CQ 5(1)(d).
57. Section CD 18 applies to provide a deduction for any US federal income tax paid by the New Zealand investor against any dividend derived from the US LLC. Section CD 18(2) includes a formula that requires factoring in any prior deductions claimed for US federal tax since inception of the investment in the US LLC. This is explained in more detail from [106].
58. No FTCs are available to be claimed against the New Zealand tax on any dividend derived from the US LLC because no US tax is paid at source on the distributions.
59. A New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the NZ-US DTA) for US federal income tax on "partnership" income against their New Zealand tax liability on dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's distributive share is not paid on the dividend distribution from the US LLC. However, the s CD 18 deduction gives a similar overall effect, albeit as a different way of recognising the US tax paid by the New Zealand investor. For a detailed example, see examples 1 and 2 (the examples start at [136]).

¹¹ If the person is a trustee, the requirements of s CQ 5(1)(e) must be met broadly restricting eligibility to testamentary trusts of a person within five years of death, certain court-ordered trusts, and trusts settled by the Accident Compensation Corporation.

Where the US LLC is a FIF and the FIF income is calculated by applying the fair dividend rate, comparative value, cost method or deemed rate of return

60. Subject to the \$50,000 FIF "exemption", a New Zealand investor who has an attributing interest must pay New Zealand tax on their FIF income. The five methods for calculating FIF income are the:¹²
- (a) fair dividend rate (FDR);
 - (b) comparative value (CV);
 - (c) cost method (CM);
 - (d) deemed rate of return (DRR); and
 - (e) attributable FIF income method (AFIM).
61. Where a New Zealand investor in a US LLC adopts any of the FDR, CV, CM or DRR FIF income calculation methods, the resulting amount from applying that method is FIF income. Any FIF income calculated under the FDR, CV, CM or DRR calculation methods is a substitute for any actual income derived by a New Zealand investor in the FIF. To avoid double taxation, any actual income derived by a New Zealand investor from a FIF (for example, dividends) who adopts any one of the FDR, CV, CM or DRR calculation methods is excluded income under ss EX 59(2) and CX 57B (that is, it is not assessable income).
62. Additionally, s CD 36 provides that where a person adopts any of the FDR, CV, CM or DRR calculation methods, any actual dividends derived from the FIF are "not a dividend". Section CD 36(1) states:

CD 36 Foreign investment fund income

Amount not dividend

- (1) An amount paid by a company to a person is not a dividend if, —
- (a) at the time the person derives the amount, the person's interest in the company is an attributing interest, or would have been if the company had not been liquidated; and
 - (b) the person calculates their foreign investment fund (FIF) income or loss in relation to the interest and the period in which the amount is paid under—
 - (i) the comparative value method;
 - (ii) the deemed rate of return method;
 - (iii) the cost method;
 - (iv) the fair dividend rate method; and
 - (c) *[Repealed]*
 - (d) the amount is excluded income under section CX 57B (Amounts derived during periods covered by calculation methods).

63. The effect of s CD 36 excluding an amount derived from a foreign company from being a dividend is that s CD 18 does not apply to a New Zealand investor in a FIF who adopts any of the FDR, CV, CM or DRR calculation methods. Section CD 18 provides relief for New Zealand investors in foreign hybrid entities by allowing a deduction for foreign tax paid against a foreign-sourced dividend derived from the

¹² The Rulings do not consider the branch equivalent and accounting profits method that were available for use for income years beginning on or before 30 June 2011.

hybrid entity. Section CD 18 cannot apply if there is no dividend (which is the effect of s CD 36).

64. Also, a New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the NZ-US DTA) for US federal income tax on their distributive share against their New Zealand tax liability on FIF income. This is because the US federal income tax paid on the New Zealand investor's distributive share is not foreign tax paid on FIF income.
65. For a detailed example, see example 3 (the examples start at [136]).
66. Relief is however available for US federal income tax paid on a NZ investor's distributive share if that investor has adopted CV to calculate their FIF income. Under s EX 51(1) there is a formula for calculating CV income. The formula is increased by "gains" and decreased by "costs". Payment of US tax on behalf of the NZ investor will be a gain as defined in s EX 51(4)(b). "Costs" in the formula are defined in s EX 51(6)(b) as including foreign income tax paid by the person on their FIF income in that income year. The gain is however offset by the fact that US tax withheld is debited to the NZ investor's capital account reducing their "closing value" in the formula which is defined in s EX 51(3). The net result is that the payment of US tax will reduce their FIF income.

Where the US LLC is a FIF and the investor adopts the AFIM

67. In general terms, a New Zealand investor in a FIF may adopt the AFIM for calculating their FIF income, provided the New Zealand investor can:
 - (a) give the Commissioner (if requested) sufficient information to enable the Commissioner to check the calculations required by s EX 50; and
 - (b) the FIF is a foreign company; and
 - (c) the person has a 10% or more income interest in the FIF; and
 - (d) the foreign company is not a CFC, unless it is a CFC that does not have a readily available market value except one calculated by independent valuation and certain other conditions apply: s EX 46(3)(b).
68. A New Zealand investor will, generally, be subject to tax on any dividends derived from the FIF and any FIF income calculated by applying the AFIM.
69. The New Zealand investor is taxed on their share of the FIF's income under ss CQ 4, CQ 5, EX 44(1)(b) and EX 50.
70. US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income is creditable against the New Zealand investor's income tax liability on attributed FIF income: s LK 1(1)(d). [Note that this is only to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and the FTCs do not relate to any foreign tax paid on any active income of the FIF.]
71. There are three New Zealand tax consequences where dividends are derived from the US LLC:
 - (a) Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

- (b) If the New Zealand investor is an individual, a dividend will be income under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.
- (c) An individual New Zealand investor may choose to be a branch equivalent tax account (BETA) person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming FTC), then the individual investor can claim a BETA tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

72. For a detailed example, see example 4 (the examples start at [136]).

Application of the CFC regime to investments in a US LLC

- 73. A CFC is defined in the Act as a foreign company controlled by New Zealand residents. A US LLC is a company and will be a "foreign company" provided it is not resident in New Zealand.
- 74. The US LLC will be "controlled" by New Zealand residents if, for example, a group of five or fewer New Zealand residents has a total control interest of more than 50% in any one of the control interest categories.
- 75. In general terms, a New Zealand investor will have attributed CFC income in a US LLC (which is a CFC) if they have an income interest in the CFC of 10% or more, the CFC has "net attributable CFC income", and the CFC is not a non-attributing active CFC.

Where the US LLC is a CFC

- 76. In summary, the New Zealand tax consequences for a US LLC that is a CFC is as follows (which is the same as the tax consequences for a New Zealand investor in a FIF where the investor adopts the AFIM):
 - (a) The New Zealand investor pays New Zealand tax on their share of attributed CFC income under ss CQ 1 and CQ 2.
 - (b) Any US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income is creditable against the New Zealand investor's CFC attributed income tax liability: s LK 1(1)(d). Note that this is only to the extent it does not exceed the New Zealand tax payable on the CFC attributed income and the FTCs do not relate to any foreign tax paid on any active income of the CFC.
 - (c) A distribution from the US LLC is a dividend for New Zealand tax purposes. The New Zealand tax consequences of the dividend distribution are as follows:
 - (i) If the investor is an individual, any dividends are assessable to the investor under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.
 - (ii) An individual investor can choose to be a BETA person under s OE 1(2).

- (iii) Where the New Zealand investor is a company, any dividends derived by the company from a foreign company are exempt income: s CW 9.

77. For a detailed example, see example 5 (the examples start at [136]).

Where the US LLC is a FIF that is a non-attributing active FIF

78. Where a New Zealand investor applies the AFIM, they may also apply the active business exemption. In simple terms, a FIF will satisfy the active business exemption where it has attributable income (income from “passive” sources) that is less than 5% of the FIF’s gross income. Where the active exemption applies, the New Zealand investor in the FIF is treated as having an exemption for holding a non-attributing active FIF interest: s CQ 5(1)(c)(xv). In these circumstances, an individual New Zealand investor will be taxed in New Zealand only on any dividend derived from the US LLC. The New Zealand investor may deduct any US federal income tax paid on their distributive share of the US LLC’s income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.

79. On the other hand, a corporate New Zealand investor is not subject to New Zealand tax, because dividends from a foreign company are exempt income: s CW 9(1).

80. For a detailed example, see example 6 (the examples start at [136]).

Where the US LLC is a non-attributing active CFC

81. Where the US LLC is a non-attributing active CFC, then the tax consequences are the same as described at [78] to [80] for a non-attributing active FIF.

82. There is no attributed income from the CFC under s CQ 2(1)(h).

83. A New Zealand investor is subject to New Zealand tax only on dividends derived from the US LLC as follows:

- (a) If the investor is an individual, any dividends are assessable to the individual investor under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC’s income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.

- (b) Where the investor is a company, any dividends derived by the company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

84. For a detailed example, see example 6 (the examples start at [136]).

What foreign taxes a New Zealand investor pays in respect of a US LLC are creditable against the investor’s FIF income, CFC income or dividend tax liability

85. Several FTC provisions may apply to a New Zealand investor in a US LLC in this context:

- (a) Sections LJ 1(1) and LJ 2(1) set out the general rule for claiming an FTC where foreign tax has been paid on a New Zealand investor's foreign-sourced income, which is also subject to New Zealand tax.
- (b) Section LJ 2(6) and (7) sets out a special rule for claiming an FTC where the New Zealand investor adopts one of the FDR, CV, CM or DRR FIF income calculation methods. Foreign tax paid on actual foreign-sourced dividends may be claimed against the New Zealand tax liability on the FIF income derived by a New Zealand investor.
- (c) Section LK 1 sets out the FTC rules that apply to a New Zealand resident investor with attributed income from a CFC or a FIF where they have adopted the AFIM.

Sections LJ 1(1) and LJ 2(1) – general rule

86. Sections LJ 1(1) and LJ 2(1) provide the general rule that a person is entitled to a tax credit for foreign tax paid against their New Zealand income tax liability in relation to foreign-sourced income. They also set out how to calculate the New Zealand tax applicable on that foreign-sourced income.

87. Section LJ 1(1) and (2)(a) provide:

LJ 1 What this subpart does

When tax credits allowed

- (1) **This subpart provides the rules for dividing assessable income from foreign-sourced amounts into segments and allows a tax credit for foreign income tax paid in relation to a segment of that income.**

Limited application of rules

- (2) The rules in this subpart apply only when—
 - (a) a person resident in New Zealand derives assessable income that is sourced from outside New Zealand; [Emphasis added]

88. Section LJ 2(1) to (3) provide:

LJ 2 Tax credits for foreign income tax

Amount of credit

- (1) **A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income,** determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

Limitation on amount of credit

- (2) The amount of the person's credit in subsection (1) must not be more than the amount of New Zealand tax payable by the person in relation to the segment calculated under section LJ 5(2), modified as necessary under section LJ 5(4).

Amount adjusted

- (3) The amount of the person's credit in subsection (1) may be reduced or increased if either section LJ 6 or LJ 7 applies. [Emphasis added]

89. A "segment of foreign source income" is defined in s LJ 4 as "a person has a **segment of foreign-sourced income** equal to an amount of assessable income

derived from 1 foreign country that comes from 1 source or is of 1 nature". For example, a dividend derived by a New Zealand investor from a US LLC would be a segment of foreign-sourced income because it is an amount of assessable income derived from one foreign country (the US) that comes from one source (the US LLC) or is of one nature (a dividend).

90. A New Zealand investor may claim a FTC against New Zealand tax payable on that foreign-sourced dividend, for an "amount of foreign tax paid" on that segment of foreign-sourced income. The FTC claimable by the New Zealand investor cannot exceed the New Zealand tax payable in relation to the foreign-sourced dividend: s LJ 2(2).
91. Section LJ 2(1) and (2) do not apply to the arrangements in the Rulings for two reasons.
92. The first reason is that no US tax is paid on the dividend distributions (segment of foreign-sourced income) that are taxed in New Zealand.
93. The second reason is that a New Zealand investor pays US federal income tax on their distributive share of the US LLC's income. However, this cannot be claimed as a FTC against the New Zealand investor's dividend income derived from the US LLC, because that foreign tax is not paid "on" that segment of foreign-sourced income under s LJ 2(1). In other words, a dividend derived by a New Zealand investor from a US LLC and the New Zealand investor's distributive share of the US LLC's income are different segments of foreign-sourced income. A New Zealand investor cannot claim a FTC for foreign tax paid on a segment of foreign-sourced income (US federal income tax on a New Zealand investor's distributive share of the US LLC's income) against the New Zealand tax liability on a different segment of foreign source income (a dividend derived from the US LLC).
94. The application of the NZ-US DTA is considered at [118] to [125]. Article 22 of the NZ-US DTA operates in essentially the same way as ss LJ 1(1) and LJ 2(1) by permitting a FTC for foreign tax paid but only on the same income, for example, a foreign-sourced dividend taxed in New Zealand and in the US.

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

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

When subsection (7) applies

- (6) Subsection (7) applies to a person who derives an amount from an attributing interest in a FIF when the amount is treated as not being income under section EX 59(2) (Codes: comparative value method, deemed rate of return method, fair dividend rate method, and cost method).

Tax credit

- (7) The person has a tax credit under this subpart for foreign income tax paid on or withheld in relation to the amount. The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the amount of FIF income from the attributing interest that the person derives in the period referred to in section EX 59(2).
96. Any FIF income calculated under the FDR, CV, CM or DDR calculation methods is a substitute for actual income derived by a New Zealand investor in the FIF. To avoid double taxation, any actual income derived from a FIF by a New Zealand investor

who adopts any one of the FDR, CV, CM or DDR calculation methods is excluded income under ss EX 59(2) and CX 57B (that is, it is not assessable income).

97. Notwithstanding this “exemption”, the special rule in s LJ 2(6) and (7) provides that any foreign tax paid on such actual income derived by a New Zealand investor may be credited against a New Zealand investor’s New Zealand tax liability on FIF income calculated under the FDR, CV, CM or DDR calculation methods. For example, if a New Zealand investor derives a foreign-sourced amount that has been subject to foreign tax, then the New Zealand investor can claim a FTC under s LJ 2(6) and (7) against their New Zealand tax liability on FIF income calculated under the FDR, CV, CM or DDR calculation methods (but not exceeding the New Zealand tax applicable on the FIF income: s LJ 2(2)).
98. However, ss LJ 2(6) and (7) do not apply to the distributions from the US LLC in the context of the arrangements in the Rulings, as no US tax is paid on the distributions from the US LLC that are dividends for New Zealand tax purposes. Sections LJ 2(6) and (7) also do not apply in relation to any US federal income tax paid by a New Zealand investor in a US LLC on their distributive share of the US LLC’s income. That “partnership” income is not income derived by the New Zealand investor for New Zealand tax purposes.

Subpart LK – CFC and FIF income

99. Where a person has attributed CFC income or applies the AFIM to their FIF interest, then that person is entitled to a FTC against their New Zealand CFC or FIF income tax liability as determined in s LK 1.
100. Section LK 1(1) provides:

LK 1 Tax credits relating to attributed CFC income

Amount of credit

- (1) A person who has an amount of attributed CFC income for an income year has a tax credit for the tax year corresponding to the income year equal to the following amounts paid or payable in relation to the attributed CFC income:
- (a) an amount of income tax paid by the CFC from which the income is derived:
 - (b) an amount of tax withheld and paid on behalf of the CFC from which the income is derived:
 - (c) the amount of foreign income tax paid by the CFC from which the income is derived:
 - (d) the amount of foreign income tax paid by the person in relation to the CFC from which the income is derived:
 - (e) the amount of foreign tax paid, under legislation of another country or territory that is equivalent of the international tax rules, by a foreign company in relation to income derived by the CFC.
101. Section LK 1(1) sets out the rules for claiming FTCs for foreign tax paid or payable by a CFC or a FIF (applying the AFIM), against a person’s New Zealand tax liability on attributed FIF or CFC income. Subpart LK is designed to accommodate timing mismatches that routinely can occur between different jurisdictions. Consequently, tax paid or payable in the US that relates to the CFC or FIF attributed income derived by a person in New Zealand can be claimed as a credit, even if not paid in the relevant income year in New Zealand. Section 93C of the Tax Administration Act 1994 assists if the amount of the credit cannot be determined before a return is filed. The Commissioner must amend an assessment upon request to reflect a

credit if the request is made within four years from the end of the relevant income year. It is not however possible to claim a FTC under s LK (1) if it relates to attributed income in a different income year. Any FTC claimed is limited to an amount that offsets the tax payable in New Zealand on the attributed FIF or CFC income derived as if it were standalone income in the relevant year. Any surplus is not refundable but may be carried forward to a subsequent income year under s LK 4 provided the loss carry forward requirements of s LK 5 are met.

102. In ordinary circumstances, the tax is paid by the CFC or FIF (that is, s LK 1(1)(c) applies). Section LK 1(1)(d) is an important exception, as it deals with the scenario where a CFC or a FIF does not itself pay the CFC's or FIF's foreign income tax, but another person does (for example, a New Zealand investor in the CFC or FIF that is a foreign hybrid entity). Section LK 1(1)(d) was introduced to enable a New Zealand investor in a CFC or a FIF (which is a hybrid company or partnership) to claim a FTC for any foreign income tax paid (for example, US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income) against their New Zealand tax liability on attributed CFC or FIF income.
103. The effect of s LK 1(1)(d) is that a New Zealand investor in a hybrid entity (for example, a US LLC) that is a CFC or a FIF (applying the AFIM) may claim a FTC for foreign tax that they pay in relation to that CFC or FIF. This is in the same way as a New Zealand investor in a foreign company that is not a hybrid entity and that is also a CFC or a FIF (applying the AFIM) may claim a tax credit for foreign tax that the CFC or FIF pays. The tax credit is available for attributed CFC and FIF (applying the AFIM) income only.

How s CD 18 applies to investments in a US LLC

104. Section CD 18 is a special provision that addresses the possible over-taxation of foreign-sourced dividend income derived by a New Zealand investor from a foreign hybrid entity. This arises where a shareholder pays the foreign tax of the hybrid entity that, in ordinary circumstances, the hybrid entity would pay, and this reduces the amount available for distribution as a dividend by the entity. Section CD 18 is directed at hybrid entities such as a US LLC, which is a company for New Zealand tax purposes but taxed as a partnership for US tax purposes. Section CD 18(1) and (2) provides:

CD 18 Dividend reduced if foreign tax paid on company's income

When this section applies

- (1) This section applies when a person—
- (a) derives a dividend from a company that is a foreign company; and
 - (b) has a liability under the laws of a country or territory outside New Zealand for income tax on income of the company corresponding to the liability that the person would have under the laws of New Zealand for income tax on income of the company if the company were a partnership in which the person were a partner; and
 - (c) pays the income tax; and
 - (d) provides to the Commissioner upon request, in the time allowed by the Commissioner, sufficient information to satisfy the Commissioner as to the amount of income tax paid.

Amount of dividend reduced

- (2) The amount of the dividend is reduced by the greater of zero and the amount calculated using the formula—

$$\text{total tax paid} - \text{earlier reductions.}$$

Definition of items in formula

- (3) In the formula,—
- (a) total tax paid is the total amount of income tax on income of the company that the person has paid in the country or territory by the time that the person derives the dividend:
 - (b) earlier reductions is the total amount of reductions under this section that, by the time that the person derives the dividend, have affected other dividends derived by the person from the company.

105. Section CD 18 works to eliminate the over-taxation of dividends derived by a New Zealand investor in a hybrid entity such as a US LLC, so that the New Zealand investor is treated for New Zealand tax purposes as deriving the same amount of dividend income as a New Zealand investor in an ordinary (that is, non-hybrid) foreign company. This outcome is achieved by allowing a New Zealand investor in a foreign hybrid entity to deduct from a dividend derived from the foreign hybrid entity, any foreign tax that the New Zealand investor pays (for example, as a “partner”) on the foreign hybrid’s income. Note that the provision only permits a deduction for tax actually paid by the time the dividend is derived. Unlike subpart LK it does not extend to “tax paid or payable” to cover any timing mismatches between New Zealand and the foreign jurisdiction. Also, any refunds of foreign tax received must reduce the amount available as a deduction under s CD 18. A New Zealand investor in a US LLC may receive a refund as a result of filing their required personal tax return in the US. The treatment of a tax refund is illustrated in example 1 from [137].
106. There is a requirement under the formula in s CD 18(2) to reconcile the foreign tax deducted from all dividends derived since inception of the investment in the company. This ensures that only amounts of foreign tax paid not already claimed as a deduction are available to reduce the dividends from the company that are taxed in New Zealand each year.
107. The application of s CD 18 is best illustrated by an example that assumes the following:
- (a) An individual New Zealand investor’s interest in a US LLC cost less than \$50,000 in a year (that is, the New Zealand investor is required to pay tax on only dividends derived from the FIF).
 - (b) The New Zealand investor’s distributive share of the US LLC’s income for federal income tax purposes is \$1,000. The US LLC makes a \$700 distribution in that year.
 - (c) The US imposes 30% (\$300) federal income tax on the New Zealand investor’s distributive share of the US LLC’s income. The US LLC withholds the tax and pays it on behalf of the New Zealand investor.
 - (d) The US LLC made a distribution to the New Zealand investor in the prior year when the interest in the LLC was first acquired and US federal income tax was paid on that and then used to reduce the dividend derived in the prior year for New Zealand tax purposes.

- (e) All amounts are expressed in New Zealand dollars.
108. For New Zealand tax purposes, the \$700 distribution and US withholding tax payment of \$300 will both be a dividend. If the full \$1,000 is taxed in New Zealand there would be over-taxation of that dividend from the New Zealand investor's perspective compared with a dividend paid by an ordinary non-hybrid foreign company, because no recognition is given to the \$300 US federal income tax the New Zealand investor paid.
109. In the case of an ordinary non-hybrid foreign company, the US company would pay the US tax of \$300 and the dividend paid to the New Zealand investor would be \$700 (after US company tax is paid). Section CD 18 achieves its objective by allowing the New Zealand investor to deduct the foreign tax that they pay on their distributive share of "partnership" income from any dividend that they derive from a foreign hybrid (the US LLC in this case).
110. In this example, the New Zealand investor is taxed on \$700 (\$1,000 – \$300), which is the same amount they would have been taxed on if the US LLC had been an ordinary US company and paid the \$300 company tax on its own income, then distributed the remaining (after tax) amount of \$700. The \$300 reduction was made after taking into account the total US federal tax paid on the US LLC since inception under the formula in s CD 18(2) and the amount of that tax used to reduce the dividend derived in the prior year.
111. In the context of the Rulings, albeit using a different mechanism than allowing FTCs, s CD 18 provides relief from the cross-jurisdictional taxation of dividends derived by New Zealand individual investors from a foreign hybrid entity. Section CD 18 deductions are available to investors in a US LLC that is a FIF or a CFC, except where the New Zealand investor is:
- (a) taxed on FIF income calculated applying one of the FDR, CV, CM or DRR FIF income calculation methods, because the dividend is "exempt" in this case; or
 - (b) a company, because dividends derived by a New Zealand company from a foreign company are exempt income.

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

112. Section OE 1(2) provides that a natural person resident in New Zealand may choose to be a BETA person and maintain a BETA. These rules apply to an investment in a CFC and a FIF (where the New Zealand investor adopts the AFIM: s OE 5).
113. The purpose of a BETA is to enable an individual investor who has a net New Zealand tax liability (after FTCs have been applied) on their attributed CFC or FIF income to credit that amount to their BETA and to use this credit to satisfy any New Zealand tax liability payable on dividends derived from the FIF or CFC.
114. A BETA allows an individual investor to claim a tax credit (for tax that they pay on attributed CFC or FIF income) against their tax liability on dividend income, in a similar way to an investor in a New Zealand resident company claims an imputation credit for underlying tax paid by the company. In both cases, the purpose of the credit is to avoid economic double taxation on the dividend derived by an individual investor.

115. A New Zealand resident company cannot maintain a BETA. However, as dividends derived from a foreign company by a New Zealand resident company are exempt income, economic double taxation does not arise.
116. The BETA tax credit is calculated by applying the formula set out in s OE 19. For example, a New Zealand investor may have attributed CFC or FIF income of \$10,000 and foreign tax paid relating to that income of \$3,000 (30%). Assume that the New Zealand investor's New Zealand tax liability is \$3,300 (33%). The New Zealand investor can satisfy the New Zealand income tax liability by applying FTCs of \$3,000 and paying the net tax liability of \$300. The net tax paid of \$300 can be credited to a person's BETA and applied against any subsequent New Zealand tax liability on any dividend derived from the CFC or FIF.
117. The New Zealand investor's right to use BETA tax credits to satisfy an income tax liability and the criteria that need to be satisfied for their use are set out in s OE 20.

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

118. A DTA can extend the circumstances where a country agrees to double taxation relief beyond their respective domestic tax laws. Two articles in the NZ–US DTA deal with relief from double taxation (arts 1(6) and 22) and may be relevant to the Rulings.

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

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

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

In accordance with, and subject to any provisions of, the law of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax for tax paid in a country outside New Zealand (which shall not affect the general principle hereof), **United States tax paid under the law of the United States** and consistently with this Convention, whether directly or by deduction, **in respect of income derived by a resident of New Zealand arising in the United States** (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) **shall be allowed as a credit against New Zealand tax payable in respect of that income**; except that such credit shall not exceed the amount of the tax that would be paid to the United States if the resident were not a United States citizen or a United States company. However, where a company which is a resident of New Zealand beneficially owns at least 10 percent of the paid-up share capital of a United States company any dividend derived by the first-mentioned company from the United States company (being dividends which, in accordance with the taxation law of New Zealand in existence at the date of signature of the Convention would be exempt from New Zealand tax) shall be exempt from New Zealand tax.

...

For the purpose of allowing relief from double taxation pursuant to this Article, income shall be deemed to arise as follows:

- (a) income derived by a resident of the United States which may be taxed in New Zealand in accordance with this Convention shall be deemed to arise in New Zealand;
- (b) **income derived by a resident of New Zealand which may be taxed in the United States** in accordance with the Convention (other than income taxed by the United States solely because the beneficial owner is a citizen of

the United States or a United States company) **shall be deemed to arise in the United States;**

- (c) For purposes of paragraph 3, income beneficially owned by a resident of New Zealand who is a citizen of the United States or a United States company shall be deemed to arise in New Zealand to the extent necessary to give effect to the provisions of this paragraph. [Emphasis added]

120. Article 22 applies to US tax paid in respect of the same income derived by a New Zealand resident and arising in the US. That is, art 22 provides relief where the same income is taxed to the same person in two tax jurisdictions.
121. In the US LLC context, an amount allocated and credited to a member's capital account and distributed to a New Zealand investor is a dividend derived for New Zealand tax purposes and will "arise" in the US. However, in terms of the arrangements in the Rulings, no US tax is paid at source on this dividend distribution, so no FTC is claimable. The New Zealand investor has paid US federal income tax on their distributive share of the US LLC's US taxable income on a partnership basis, but that is not US tax paid on the distribution to the New Zealand investor (which is a dividend for New Zealand tax purposes).

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

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

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

123. Article 1(6) applies to a foreign investment by a New Zealand or US resident through a transparent entity. Income derived through a transparent entity is taxed to a New Zealand or US resident only where that entity is treated as transparent for the purposes of New Zealand and US tax law respectively; for example, a New Zealand investor in a partnership established in the US that is also a partnership for New Zealand tax purposes. The US partnership is a partnership for New Zealand tax purposes and is transparent for New Zealand tax purposes: s HG 2. In these circumstances, the New Zealand partner is taxed directly on their share of the partnership income.
124. Article 1(6) does not apply to a New Zealand investor in a US LLC.¹³ A New Zealand investor derives partnership income under US federal income tax law (which satisfies the first part of art 1(6)), but that partnership income is not treated for the purposes of the taxation law of New Zealand as the income, profit or gain of the New Zealand investor in the US LLC (so the second part of art 1(6) is not satisfied). This is because the US LLC is a company and not a transparent entity for New Zealand tax purposes.
125. Article 1(6) does not apply to the facts of the Rulings.

¹³ This is confirmed in the (US) *Department of the Treasury Technical Explanation of the Protocol Between the United States of America and New Zealand...signed at Wellington on July 23, 1982*, in an example at the last paragraph of pg 4.

Overseas authority

126. The United Kingdom (UK) Supreme Court in *Anson v Commissioners for HMRC* [2015] UKSC 44 considered a dispute where the facts were materially similar to those in the Rulings. The court reached a different conclusion from the Commissioner's conclusion in the Rulings. This raises the question, to what extent, if any, does *Anson* apply in New Zealand?
127. *Anson* involved a UK investor in a Delaware LLC. The dispute revolved around whether Anson was entitled to a FTC for US tax he paid on his distributive share of the US LLC's income against UK tax paid on distributions from the US LLC. Her Majesty's Revenue and Customs argued that no FTC was available because the distribution that was taxed in the UK was not the same income as Anson's distributive share of the US LLC's income on which the US tax had been paid. On the other hand, Anson argued that the income taxed in the US and UK was the same income, so he was entitled to a FTC for US tax paid.
128. The UK Supreme Court confirmed on appeal the reasoning of the First Tier Tribunal in *Mr Swift v Commissioners for HMRC* [2010] UKFTT 88 (TC). The UK Supreme Court concluded that the taxpayer was entitled to the profits of the US LLC as they arose because of the effect of § 18-503 of the LLC Act (2014 Delaware Code) and art IV of the US LLC's operating agreement, so the US LLC should be categorised as a transparent entity (and the members taxed directly on the profits of the US LLC). In its judgment, the tribunal concluded that the characteristics of the US LLC were such that it was more akin to a partnership than a company. The Delaware LLC Act (§ 18-503) required that the profits and losses of an LLC were to be allocated to members in accordance with the US LLC's operating agreement. Article IV of the US LLC's operating agreement provided the US LLC's gross income and expenses were to be credited and debited to a member's capital account respectively.
129. Where the Commissioner is required to classify a foreign entity, such as a US LLC, for domestic tax law purposes, the approach adopted is to identify the key legal characteristics of the foreign entity and then to classify that entity by reference to New Zealand domestic tax law definitions (e.g. company or partnership). This approach is discussed in L Collins, *Dicey and Morris on the Conflict of Laws* (13th ed, Sweet & Maxwell, London, 2000) at [2.009]:
- If the forum has to characterise a rule or institution of foreign law, it should inquire how the corresponding or most closely analogous rule or institution of its own law is characterised, and apply that characterisation to the foreign institution or rule.
130. Applying this approach, the potentially relevant corresponding or analogous entities for New Zealand tax purposes are a company, look-through company and partnership.
131. It is the Commissioner's view that a US LLC is a company for New Zealand tax purposes for the reasons discussed at [21] to [25]. Additionally, the New Zealand legislative scheme provides that if a company owns and conducts a business, then the company (not the shareholders or members of the company) will be treated as deriving the income that it earns from the conduct of that business: s CB 1. In this context, a US LLC is a company and a separate legal entity. The US LLC owns the business assets, and the US LLC (not its members) conducts the business of the US LLC. Accordingly, under the scheme of the Act, the US LLC (not its members) is treated as deriving the income that it earns.

132. The Commissioner does not consider that a US LLC is a look-through company or a partnership for New Zealand tax purposes. A look-through company is a special type of company for New Zealand tax purposes, where, provided certain criteria are met, the shareholders are taxed on a look-through basis akin to a partnership – like a US LLC. One of the criteria for being a look-through company is that the company is resident in New Zealand. An underlying assumption in the Rulings is that the US LLC is a foreign company (that is, it is not resident in New Zealand). Therefore, US LLCs that these Rulings apply to are not look-through companies for New Zealand tax purposes.
133. A US LLC is not a partnership for New Zealand partnership law or tax purposes because the essential criterion for being a partnership is absent; that is, no relationship exists between persons (members in this context) carrying on business for profit (because it is the US LLC that carries on the business). A New Zealand investor in a US LLC would be taxed directly on the profits of a US LLC only if it were a partnership for New Zealand tax purposes.
134. The Commissioner does not consider that *Anson* applies in New Zealand. In *Anson*, an important element of the UK court’s reasoning was that the US LLC was akin to a Scottish partnership so should be treated as a transparent entity and its UK members taxed on a look-through basis. The Commissioner considers that the UK approach to categorising a foreign hybrid entity as transparent or opaque, based on whether that entity has features more akin to a partnership or company does not apply in New Zealand. In New Zealand, entities and transactions are characterised according to their legal form and not what transaction or entities they most closely resemble: *Mills v Dowdall* [1983] NZLR 154 (CA) at 159. The Commissioner considers that a US LLC is a company because the legal characteristics of the US LLC meet the New Zealand tax definition of company and not merely because it more closely resembles a company than a partnership.
135. Section CD 18 is also an important feature of the scheme of the Act dealing with foreign hybrid entities. Section CD 18 deals explicitly with company–partnership foreign hybrids (US LLCs in this context) and the over-taxation of foreign source dividend income derived from a foreign hybrid entity. Section CD 18 permits a New Zealand investor in a foreign hybrid entity to deduct the foreign tax that they have paid from the dividend they derive from the foreign company. Section CD 18 is premised on the foreign hybrid entity (US LLC in this context) being a company that derives its own income and pays a dividend to its shareholder (even though it is taxed as a partnership in the foreign tax jurisdiction).

Examples

136. The following six examples have common features:
- (a) A New Zealand investor (natural person or company) invests in a US LLC and is not the sole shareholder.
 - (b) The US LLC is a company for New Zealand tax purposes.
 - (c) The US LLC owns the assets of the business, and the business is conducted by the US LLC and not by its members.
 - (d) The US LLC is treated as a partnership in the US, has not made an election to be taxed as a corporation and the New Zealand investor is subject to US federal income tax on their distributive share of the US LLC’s income.

- (e) The New Zealand investor's US federal income tax liability is withheld by the US LLC and paid on behalf of its New Zealand investors.
- (f) The New Zealand investor is required to and does file a US tax return including their distributive share of the US LLC income and tax withheld on their behalf by the US LLC.
- (g) The payment of US federal income tax by the US LLC withheld on behalf of its New Zealand investors is treated in the US LLC's accounts as a distribution to the investors (that is, as a debit to the member's capital account).
- (h) The payment by the US LLC of the member's US federal income tax on their behalf is a distribution and a dividend for New Zealand tax purposes.
- (i) The Managing Members of the US LLC have the power to make distributions in their sole discretion. (Note that this feature does not apply to example 1.)
- (j) No US tax is paid on distributions from the US LLC, which are dividends for New Zealand tax purposes.
- (k) The US federal income tax rate is assumed to be 30%.
- (l) Where the New Zealand investor is a natural person, it is assumed they have a marginal tax rate of 33%, are not a transitional resident, and have not opted into the FIF rules where the FIF interests they hold are \$50,000 or less.
- (m) All amounts are expressed in New Zealand dollars.

Example 1: Individual New Zealand investor's investment in a US LLC is under the \$50,000 FIF threshold and distributions to members are mandatory

Circumstances

- 137. An individual New Zealand investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of the individual investor's attributing interest in FIFs does not exceed \$50,000 throughout the year.
- 138. The New Zealand investor can withdraw amounts from their capital account, representing their share of the US LLC's annual net accounting profits on request, subject to cash being available.
- 139. The New Zealand investor's share of the US LLC's net accounting profit is \$1,100, as determined by the US LLC's operating agreement. This share is credited to the New Zealand investor's capital account in year 1. The New Zealand investor can withdraw this amount from their capital account as they wish.
- 140. The New Zealand investor's distributive share of the US LLC's income for US federal income tax purposes is \$1,000, and the US federal income tax liability on that income is \$300 (30%). The distributive share is the NZ investor's proportional share of net accounting profits adjusted as required to meet US tax requirements.
- 141. The New Zealand investor's US federal tax liability is withheld by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account) in year 1.

142. The US LLC subsequently distributes \$700 to the New Zealand investor in year 2. The New Zealand Investor also receives a US tax refund of \$50 in year 2 after filing their US tax return for year 1.
143. Years 1 and 2 correspond to two different New Zealand income tax years – New Zealand income tax years 1 and 2.

New Zealand tax consequences

144. The New Zealand investor will be taxed on the \$1,100 dividend (the amount credited to their capital account and able to be withdrawn by the New Zealand investor) derived from the US LLC under s CD 1. The investor is not required to calculate income under the FIF rules under s CQ 5(1)(d). The New Zealand investor will be subject to tax on this dividend in New Zealand in income tax year 1, being the year in which the amount was credited to the New Zealand investor's capital account and available for the New Zealand investor to withdraw.
145. The total distribution of \$1,000 (the \$700 distribution and the \$300 US federal income tax paid by the US LLC on behalf of the New Zealand investor) is not subject to New Zealand tax. This is because the dividend has already been subject to New Zealand tax in New Zealand income tax year 1. The dividend cannot be taxed twice due to s BD 3(6).
146. Section CD 18 applies to provide a deduction for the US federal income tax paid by the New Zealand investor (\$300) in year 1. In other words, the New Zealand investor's income is \$1,100 (the dividend) less \$300 (the US tax paid by the New Zealand investor). The New Zealand investor pays New Zealand income tax (at 33%) on the net dividend of \$800 (\$264). Both the US tax of \$300 taken as a reduction of dividend income and the \$50 tax refund received in year 2 decrease the amount of US tax that can be claimed in future under s CD 18 from year 2 onwards.
147. The New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the New Zealand–US DTA) for US federal income tax on the distributive share of the US LLC's income against their New Zealand tax liability on dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's distributive share is not US tax paid on a dividend derived from the US LLC.

Example 2: Individual New Zealand investor's investment in a US LLC is under the \$50,000 FIF threshold and distributions are not mandatory

Circumstances

148. An individual New Zealand investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of the individual investor's attributing interest in FIFs does not exceed \$50,000 throughout the year.
149. The New Zealand investor's distributive share of the US LLC's income for US federal income tax purposes is \$1,000, and the US federal income tax liability on that income is \$300 (30%).

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

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

New Zealand tax consequences

152. The New Zealand investor will be taxed on only the actual dividends (the \$700 distribution and \$300 US federal income tax paid by US LLC on behalf of the New Zealand investor) derived from the US LLC under s CD 1. The investor is not required to calculate income under the FIF rules under s CQ 5(1)(d).

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

154. The New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the New Zealand-US DTA) for US federal income tax paid on the distributive share against their New Zealand tax liability on the \$1,000 distribution treated as dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's US LLC distributive share is not paid on the dividend distribution from the US LLC.

Example 3: Individual New Zealand investor in a US LLC adopts one of four FIF income calculation methods

Circumstances

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

156. The New Zealand investor adopts one of the four income calculation methods: FDR, CV, CM or DRR.

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

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

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

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

New Zealand tax consequences

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

162. The total distribution of \$2,740 (the \$1,900 distribution and the \$840 US federal income tax paid by the US LLC on behalf of the New Zealand investor) paid to the New Zealand investor by the US LLC is excluded income under ss EX 59(2) and CX 57B. It is also explicitly excluded from being a dividend for New Zealand tax purposes under s CD 36. Section CD 36 deems a distribution not to be a dividend where a person adopts any of the four methods (FDR, CV, CM or DRR) of calculating FIF income.
163. Section CD 18, which provides relief from the over-taxation of dividend distributions from foreign hybrid entities, does not apply because the distribution is deemed not to be a dividend under s CD 36.
164. A New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the New Zealand–US DTA) for US federal income tax on their distributive share against their New Zealand tax liability on FIF income. This is because the US federal income tax paid on the New Zealand investor’s distributive share is not foreign tax paid on FIF income.
165. A New Zealand investor who adopts CV for their FIF income will treat the payment of the \$840 of US tax on its behalf as a cost, a gain and as a reduction of the closing value under the formula in s EX 51(1) when calculating their FIF income.

Example 4: New Zealand investor adopts the AFIM for calculating FIF income

Circumstances

166. A New Zealand investor (a company or individual) invests in a US LLC that is a FIF for New Zealand tax purposes. The New Zealand investor adopts the AFIM for calculating FIF income.
167. The New Zealand investor’s FIF attributed income is \$2,000 in their first year of holding the US LLC.
168. The New Zealand investor’s distributive share of the US LLC’s income for federal income tax purposes is \$2,100, and the US federal income tax liability on that income in the first year is \$630 (30%).
169. The New Zealand investor’s US federal tax liability (\$630) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor’s capital account).
170. The US LLC subsequently distributes \$1,400 to the New Zealand investor.

New Zealand tax consequences

171. The New Zealand investor is subject to New Zealand income tax on FIF income and on any dividends (if they are an individual) derived from the US LLC.
172. The New Zealand investor is taxed on their share of the FIF’s income (\$2,000), and New Zealand tax is \$660 (33% if an individual) or \$560 (28% if a company) under ss CQ 4, CQ 5, EX 44(1)(b) and EX 50.
173. The US federal income tax paid (\$630) by the New Zealand investor on their share of the US LLC’s income is creditable against the New Zealand investor’s FIF

attributed income tax liability: s LK 1(1)(d). Note that this is only to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and the FTCs do not relate to any foreign tax paid on any active income of the FIF. The individual New Zealand investor's net New Zealand tax liability is \$660 less \$630 (the FTC for US tax paid on their distributive share of the US LLC's profit), which equals \$30 net New Zealand tax payable. For a company investor, no further NZ tax is payable as the FTC exceeds the NZ tax amount (\$560-\$630).

174. The total distribution of \$2,030 (the \$1400 distribution and the \$630 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend for New Zealand tax purposes and taxable income of the individual New Zealand investor. The New Zealand tax consequences of the dividend distribution are as follows:
- (a) Where the New Zealand investor is a company any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.
 - (b) If the New Zealand investor is an individual, then the \$2,030 dividend is income under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their share of the US LLC's income (\$630) from the dividend derived from the US LLC (\$2,030): s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend (that is, net of foreign tax paid by them in the US, which is \$1400).
 - (c) An individual New Zealand investor may choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming an FTC), then the individual investor may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.
 - (d) The net New Zealand tax liability after FTCs is \$30 (the FIF income tax liability of \$660 (\$2,000 FIF income x 33% tax rate) less FTC \$630 = \$30). The \$30 may be used as a BETA tax credit to satisfy any New Zealand tax liability on dividends derived from the FIF.

Example 5: Investment in a US LLC that is a CFC

Circumstances

175. A New Zealand investor (company or individual) invests in a US LLC that is a CFC.
176. The New Zealand investor's CFC income is \$2,000 in the first year of their investment.
177. The New Zealand investor's distributive share of the US LLC's income in that same year is also \$1,900. The US federal income tax liability on that income is \$570 (30%).
178. The New Zealand investor's US federal tax liability (\$570) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).
179. The US LLC subsequently distributes \$1,300 to the New Zealand investor.

New Zealand tax consequences

180. The New Zealand investor is subject to New Zealand income tax on CFC income and any dividends derived from the US LLC.
181. The New Zealand investor is taxed on their share of the CFC's income that is, \$2,000 and New Zealand tax (at 33%) for the individual is \$660 and (at 28%) for the company is \$560 under ss CQ 1 and CQ 2.
182. The US federal income tax paid (\$570) by the New Zealand investor on their share of the US LLC's income in the same year they acquired the investment is creditable against the New Zealand investor's CFC attributed income tax liability: s LK 1(1)(d). Note that this is only to the extent it does not exceed the New Zealand tax payable on the CFC attributed income and the FTCs do not relate to any foreign tax paid on any active income of the CFC. The individual New Zealand investor's net New Zealand tax liability is \$660 less \$570 (the FTC for US tax paid on their share of the US LLC's profit), which equals \$90 net New Zealand tax payable. Where the New Zealand investor is a company there is no further New Zealand tax liability as the FTC of \$570 exceeds the NZ tax liability of \$560.
183. The total distribution of \$1,870 (the \$1,300 distribution and the \$570 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend for New Zealand tax purposes and taxable income of the individual New Zealand investor. The New Zealand tax consequences of the dividend distribution are as follows:
- (a) Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.
 - (b) If the New Zealand investor is an individual, then the \$1,870 dividend is income in terms of s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income (\$570) from the dividend derived from the US LLC (\$1,870): s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend (that is, net of foreign tax paid by them in the US, which is \$1,300).
 - (c) An individual New Zealand investor can choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming FTC), then the individual investor may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed CFC income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.
 - (d) There is a net New Zealand tax liability after FTCs of \$90 (the FIF income tax liability of \$660 (\$2,000 FIF income x 33% tax rate) – FTC \$570 = \$90). The \$90 may be used as a BETA tax credit to satisfy any New Zealand tax liability on dividends derived from the CFC.

Example 6: Investment in a US LLC that is a non-attributing active FIF or a non-attributing active CFC

Circumstances

184. A New Zealand investor (company or individual) invests in a US LLC that is a non-attributing active FIF or CFC.
185. The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes in their first year of investment is \$1,000, and the US federal income tax liability on that income is \$300 (30%).
186. The New Zealand investor's US federal tax liability (\$300) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).
187. The US LLC subsequently distributes \$700 to the New Zealand investor.

New Zealand tax consequences

188. There is no attributed income for either CFC or FIF purposes under s CQ 2(1)(h) or s CQ 5(1)(c)(xv) respectively.
189. The individual New Zealand investor is subject to New Zealand tax on only the \$1,000 dividend distribution.
190. The New Zealand tax consequences of the dividend distribution are as follows:
 - (a) Where the investor is a company, any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.
 - (b) If the investor is an individual, then the \$1,000 dividend (the \$700 distribution and the \$300 US federal income tax paid by US LLC on behalf of the New Zealand investor) is assessable to the individual investor under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their share of the US LLC's income (\$300) from the dividend derived from the US LLC (\$1,000): s CD 18. The individual New Zealand investor is subject to New Zealand tax on the net dividend (that is, net of foreign tax paid by them in the US, which is \$700).
 - (c) An individual New Zealand investor can choose to be a BETA person under s OE 1(2). However, as there is no FIF or CFC attributed income for the income year, no BETA credit is available for that year.

References

Legislative references

2014 Delaware Code, § 18-503

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

Income Tax Act 2007, ss BD 3, CB 1, CD 1, CD 3 to CD 20, CD 36, CQ 1, CQ 2, CQ 4, CQ 5, CW 9, CX 57B, EX 28 to EX 37, EX 37B, EX 38 to EX 42, EX 42B, EX 43, EX 44, EX 46, EX 50, EX 51, EX 59, HG 2, LJ 1, LJ 2, LJ 4, LK 1, LK 4, K 5 subpart OE, YA 1 ("company", "foreign company", "partnership", "share")

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

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

Partnership Act 1908, s 4

Tax Administration Act 1994, s 93C

Case references

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

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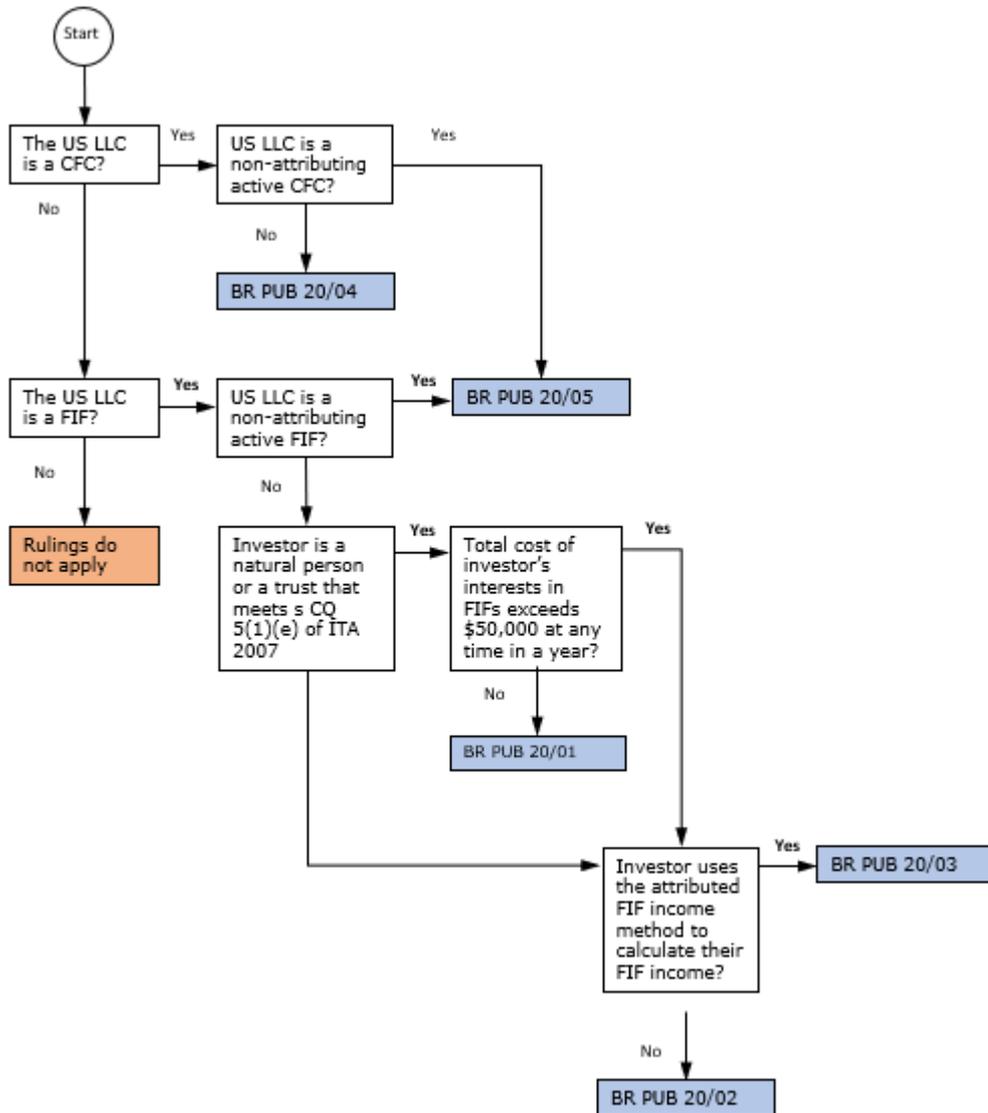
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Abbreviations

AFIM	attributable foreign investment fund income method
art, arts	article, articles
BETA	branch equivalent tax account
CFC	controlled foreign corporation
CM	cost method
CV	comparative value
DRR	deemed rate of return.
FDR	fair dividend rate
FIF	foreign investment fund
FTC	foreign tax credit
NZ-US DTA	Double Taxation Relief (United States of America) Order 1983
s, ss	section, sections
US LLC	United States limited liability company

Appendix:

Which Ruling applies to my situation?



Tax treatment of income derived by a NZ investor from a US LLC

Jurisdiction	United States	New Zealand	
	<pre> graph TD A([US Limited Liability Company (US LLC)]) --> B([NZ Member]) A --> C([NZ shareholder]) </pre>		
Income tax treatment of US LLC	Partnership if more than one member unless elects to be a corporation	Foreign company	
Taxation of income derived by investor	Distributive share LLC withholds US federal income tax from NZ member's distributive share of US LLC's income.	FIF/CFC income Investor pays income tax on FIF income or CFC income derived from LLC.	Distributions Non-corporate investors pay income tax on distributions from US LLC that are dividends.
Double taxation relief available in New Zealand		Foreign tax credit for US federal income tax paid available for FIF-AFIM and attributing CFCs. Relief for US federal income tax paid available when comparative value method used for FIF income.	Deduction under s CD 18 for US tax paid where dividend taxable BETA credit available for non-corporate investors who derive FIF-AFIM or CFC attributed income

FIF table

US LLC is a FIF: Tax treatment of income amounts and double taxation relief for income derived by NZ investor			Non-attributing active FIF	FIF income – AFIM method	FIF income – other methods	No FIF income - Total FIF interests < \$50K
Natural persons and trusts that meet s CQ 5(1)(e) of ITA	Share of LLC profits	FIF income?	N	Y	Y	N/A
		FTC?	N	Y – capped at NZ tax	N	N/A
	Distribution	Income tax treatment	Taxable Dividend	Taxable Dividend	Not a dividend	Taxable dividend
		CD 18 deduction?	Y	Y	N	Y
		BETA?	N/A	Y	N	N/A
Other persons who are not corporates	Share of LLC profits	FIF income?	N	Y	Y	N/A
		FTC?	N	Y – capped at NZ tax	N	N/A
	Distribution	Income tax treatment	Taxable dividend	Taxable dividend	Not a dividend	N/A
		CD 18 deduction?	Y	Y	N	N/A
		BETA?	N/A	Y	N	N/A
Companies	Share of LLC profits	FIF income?	N	Y	Y	N/A
		FTC?	N	Y-capped at NZ tax	N	N/A
	Distribution	Income tax treatment	Exempt dividend	Exempt dividend	Not a dividend	N/A
		CD 18 deduction?	N/A	N/A	N/A	N/A
		BETA?	N/A	N/A	N/A	N/A

CFC table

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