Vol 35 No 8 September 2023

# TAX INFORMATION Bulletin

## CONTENTS


2 **New legislation**

SL2023/179 – Order in Council: Taxation (Use of Money Interest Rates) Amendment Regulations (No 2) 2023

SL2023/184 – Order in Council: Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2023

4 **Ruling**

BR Pub 23/09 – 23/13: Investing into a US limited liability company – New Zealand tax consequences

43 **Question we've been asked**

QB 23/07: GST - Directors and board members providing their services through a personal services company

46 **Technical decision summary**

TDS 23/10: Distributions from private foundation on dissolution


Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

# YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **taxtechnical.ird.govt.nz** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Tax Counsel Office
Inland Revenue PO Box 2198 Wellington 6140

You can also subscribe at **ird.govt.nz/subscription-service/subscription-form** to receive regular email updates when we publish new draft items for comment.

## Your opportunity to comment

| Ref | Draft type | Title | Comment deadline |
|---|---|---|---|
| PUB00355 | Interpretation statement | GST Grouping for Companies | 14 September 2023 |
| PUB00322 | Interpretation statement | GST - Who can group register? | 14 September 2023 |
| PUB00433 | Interpretation statement | Income tax: Income – when gifts are assessable income | 18 September 2023 |
| ED00249 | Determination | Amortisation Rates of Listed Horticultural Plants | 28 September 2023 |
| PUB00375 | Interpretation statement | Taxation of Trusts | 13 October 2023 |

# IN SUMMARY


## New legislation

**SL2023/179 – Order in Council: Taxation (Use of Money Interest Rates) Amendment Regulations (No 2) 2023** 2

Changes have been made by Order in Council to the use of money interest rates on underpayments or overpayments of tax in line with recent changes in market interest rates. These rates apply on and after 29 August 2023.

**SL2023/184 – Order in Council: Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2023** 3

Changes have been made by Order in Council to increase the fringe benefit tax prescribed rate of interest for low-interest employment-related loans from 7.89% to 8.41%. The new prescribed rate applies for the quarter beginning 1 October 2023 and subsequent quarters.

## Ruling

**BR Pub 23/09 – 23/13: Investing into a US limited liability company – New Zealand tax consequences** 4

These five Public Rulings and the accompanying commentary set out the income tax treatment and availability of foreign tax credits or other forms of double taxation relief for New Zealand investors in a United States limited liability company (US LLC) that is taxed on a fiscally transparent basis as a partnership in the US, but as a foreign company in New Zealand. The Rulings demonstrate the respective tax treatments where the interest in the US LLC is classified as under the foreign investment fund (FIF) threshold, a FIF or a controlled foreign company (CFC); where different FIF methods are used and where there is a non-attributing active FIF or CFC.

## Question we've been asked

**QB 23/07: GST - Directors and board members providing their services through a personal services company** 43

This Question We've Been Asked considers the GST treatment of a director or board member who provides their services through a personal services company.

## Technical decision summary

**TDS 23/10: Distributions from private foundation on dissolution** 46

Whether the distributions by a private foundation on dissolution are taxable in the hands of a New Zealand resident taxpayer.

# NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

## Order in Council – Taxation (Use of Money Interest Rates) Amendment Regulations (No 2) 2023

### Order (SL2023/179)

*Sections 120E and 120H of the Tax Administration Act 1994*

The Taxation (Use of Money Interest Rates) Amendment Regulations (No 2) 2023 order was made on 24 July 2023. The Order in Council changes the use of money interest (UOMI) rate on underpayments and overpayments of taxes and duties in line with market interest rates.

The new underpayment rate is 10.91% (previously 10.39%). The new overpayment rate is 4.67% (previously 3.53%).

#### Background

The UOMI underpayment rate is charged to taxpayers on underpayments of tax to Inland Revenue, while the UOMI overpayment rate is paid to taxpayers on money paid to Inland Revenue exceeding their tax liability.

Section 120H(1)(b) of the Tax Administration Act 1994 permits the making of regulations by Order in Council to set the UOMI underpayment and overpayment rates. Once a rate is set, it remains at that rate until changed by a subsequent Order in Council.

The UOMI underpayment rate is based on the 'floating first mortgage new customer housing rate' series published by the Reserve Bank (RBNZ) each month, while the UOMI overpayment rate is based on RBNZ's '90-day bank bill rate' series each month. The UOMI rates are both adjusted if either the RBNZ 90-day bank bill rate or the floating first mortgage new customer housing rate moves by 1% or more, or if one of these indexes moves by 0.2% or more and the UOMI rates have not been adjusted in the last 12 months.

The UOMI rates are adjusted as required to ensure they are in line with market interest rates. The new UOMI underpayment and overpayment rates are consistent with the floating first mortgage new customer housing rate and the 90-day bank bill rate.

#### Effective date

The new UOMI underpayment and overpayment rates apply on and after 29 August 2023.

### Further information

The new regulations can be found at:

**https://www.legislation.govt.nz/regulation/public/2023/0179/9.0/whole.html**

# Order in Council – Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2023

## Order (SL2023/184)

*Sections RA 21(3) and (4) of the Income Tax Act 2007*

On 31 July 2023, the Order in Council – Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2023 was made. The regulations increase the fringe benefit tax (FBT) prescribed rate of interest for low-interest employment-related loans from 7.89% to 8.41%.

### Background

The FBT rules tax non-cash benefits provided to employees. Included in the definition of 'fringe benefit' is any employment-related loan on which the employer is charging a rate of interest that is below the market rate. The interest differential is taxable.

A prescribed rate set by regulations is used as a proxy for the market rate of interest to save employers the compliance costs associated with determining the market rate relevant to loans they have provided to their employees.

Section RA 21(3) of the Income Tax Act 2007 permits the making of regulations by Order in Council to set a prescribed rate of interest for calculating FBT on low-interest loans. Once a rate is set, it remains the prescribed rate until changed by a subsequent Order in Council.

By administrative convention, the FBT prescribed rate of interest is based on the 'floating first mortgage new customer housing rate' series published by the Reserve Bank (RBNZ) each month. It is updated when there has been an increase or decrease in the RBNZ rate of 20 or more basis points since the FBT rate was last set. The RBNZ rate for May 2023 was 8.41%. This is up from 7.89%, the rate for December 2022, when the FBT prescribed rate of interest was last set. The FBT prescribed rate of interest is being lifted accordingly.

### Effective date

The new prescribed rate of 8.41% applies for the quarter beginning 1 October 2023 and subsequent quarters.

## Further information

The new regulations can be found at:

**https://www.legislation.govt.nz/regulation/public/2023/0184/4.0/whole.html**

# BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

## BR Pub 23/09 – 23/13: Investing into a US limited liability company – New Zealand tax consequences

Issued | Tukuna: 24 July 2023

These five Public Rulings and the accompanying commentary set out the income tax treatment and availability of foreign tax credits or other forms of double taxation relief for New Zealand investors in a United States limited liability company (US LLC) that is taxed on a fiscally transparent basis as a partnership in the US, but as a foreign company in New Zealand.  The Rulings demonstrate the respective tax treatments where the interest in the US LLC is classified as under the foreign investment fund (FIF) threshold, a FIF or a controlled foreign company (CFC); where different FIF methods are used and where there is a non-attributing active FIF or CFC.

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



**REPLACES | WHAKAKAPIA**

This is a reissue of BR Pub 20/01 – 20/05.  For more information about the earlier publication of this Public Ruling, see the Commentary to this Ruling.

### Public Ruling BR Pub 23/09: Income tax – Dividends derived by New Zealand resident investor in a United States limited liability company that is a foreign investment fund, where the total cost of all the investor's attributing interests is $50,000 or less

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

#### Taxation laws | Ture tāke

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

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

#### The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is as follows:

- A New Zealand investor is one of the members of a United States limited liability company (US LLC) that has not made an election to be taxed as a corporation in the US.
- The New Zealand investor either is a natural person who is not a transitional resident or is a trustee that meets the requirements of s CQ 5(5).
- The US LLC investment is an attributing foreign investment fund (FIF) interest as described in s EX 29, where the total cost of all of the New Zealand investor's attributing interests in all FIFs is $50,000 or less throughout the year so the circumstances under s CQ 5(1)(d)(i) or s CQ 5(1)(e)(i), as relevant, do not apply.

- The circumstances in s CQ 5(1)(d)(ii) and (iii) or s CQ 5(1)(e)(ii) and (iii), as relevant, do not apply.
- The US LLC makes a distribution to the New Zealand investor.
- The US LLC withholds and pays US federal income tax on the New Zealand investor's partnership income on the investor's behalf.
- No US federal income tax is paid on the distribution from the US LLC to the New Zealand 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.
- All amounts are expressed in New Zealand dollars.

For the purposes of this Ruling, the term:

- "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;
- "FIF" means a FIF 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; and
- "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.

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

## How the taxation laws apply to the Arrangement | Ko te pānga o ngā ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- The New Zealand investor does not have FIF income under s CQ 5(1) as the circumstances in s CQ 5(1)(d) or s CQ 5(1)(e), as relevant, do not apply.
- The distribution from the US LLC to the New Zealand investor will be a dividend and therefore income under s CD 1.
- The New Zealand investor may reduce the amount of their dividend derived from the US LLC under s CD 18 to take into account US federal income tax paid on their partnership income. The amount of the reduction is calculated using the formula in s CD 18(2). This formula takes into account the total federal income tax paid on the US LLC interest since acquiring it, any refund, and the amounts of such tax that have already reduced other dividends of the New Zealand investor in accordance with s CD 18.
- The New Zealand 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 for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply for the period beginning 26 June 2023 and ending 5 years from that date.

This Ruling is signed by me on 24 July 2023.

**Rhonda Gregory**

Senior Tax Counsel, Tax Counsel Office | Rōia Tāke, Te Tari Tohutohu Tāke

BINDING RULINGS

# Public Ruling BR Pub 23/10: Income tax – Foreign investment fund income and dividends 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 | Ture tāke

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

This Ruling applies in respect of sections CD 1, CD 3, CD 18, CD 36, CQ 4, CQ 5, CQ 6, CX 57B, EX 1, EX 28, EX 29, EX 44, EX 51, EX 59(2), LJ 1(1) and LJ 2(1), and the Double Taxation Relief (United States of America) Order 1983.

## The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is as follows:

- A New Zealand investor is one of the members of a United States limited liability company (US LLC) that has not elected to be taxed as a corporation in the US.
- The US LLC investment is an attributing foreign investment fund (FIF) interest as described in s EX 29 for the New Zealand investor.
- Where the New Zealand investor is a natural person who is not a transitional resident, or a trustee who meets the requirements of s CQ 5(5), the total cost of all of their attributing interests in FIFs throughout the year is greater than $50,000, or they have opted in to the FIF rules under s CQ 5(1)(d)(ii) or (iii) or s CQ 5(1)(e)(ii) or (iii).
- The New Zealand investor can adopt and chooses to adopt one of the following FIF income calculation methods subject to any limitations under s EX 44(2): the fair dividend rate, comparative value, cost method or deemed rate of return.
- The US LLC makes a distribution to the New Zealand investor.
- The US LLC withholds US federal income tax and pays it on the New Zealand investor's partnership income on the investor's behalf.
- No US federal income tax is payable on the distribution from the US LLC to the New Zealand 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.
- All amounts are expressed in New Zealand dollars.

For the purposes of this Ruling, the term:

- "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;
- "FIF" means a FIF 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; and
- "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.

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

## How the taxation laws apply to the Arrangement | Ko te pānga o ngā ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- The New Zealand investor will be subject to tax on their FIF income as calculated by applying one of the FIF calculation methods available to them (the fair dividend rate, comparative value, cost method or deemed rate of return) under ss CQ 4, CQ 5 and EX 44.
- If the New Zealand investor is able to use the comparative value 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). The amount is also a gain under s EX 51(4) and a reduction in the closing value under s EX 51(3) in the formula. The overall net result is a reduction in FIF income as calculated under s EX 51(1) by the amount of the US federal income tax paid.
- Any amount derived by the New Zealand investor from their interest in the FIF (other than FIF income) is excluded income under ss EX 59(2) and CX 57B.
- A distribution the US LLC pays to the New Zealand investor 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 New Zealand investor is deemed not to be a dividend under s CD 36.
- The New Zealand 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 for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply for the period beginning 26 June 2023 and ending 5 years from that date.

This Ruling is signed by me on 24 July 2023.

**Rhonda Gregory**

Senior Tax Counsel, Tax Counsel Office | Rōia Tāke, Te Tari Tohutohu Tāke

# Public Ruling BR Pub 23/11: Income tax – Attributed foreign investment fund income and dividends 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 | Ture tāke

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

This Ruling applies in respect of ss CD 1, CD 3, CD 18, CQ 4, CQ 5, CQ 6, CW 9, EX 1, EX 28, EX 29, EX 44(1)(b), EX 50, LK 1(1)(d), OE 1(2) and OE 20, and the Double Taxation Relief (United States of America) Order 1983.

## The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is as follows:

- A New Zealand investor is one of the members of a United States limited liability company (US LLC) that has not made an election to be taxed as a corporation in the US.
- The US LLC investment is an attributing foreign investment fund (FIF) interest as described in s EX 29 for the New Zealand investor.
- Where the New Zealand investor is a natural person who is not a transitional resident, or a trustee who meets the requirements of s CQ 5(5), the total cost of their attributing interests in FIFs throughout the year is greater than $50,000, or they have opted in to the FIF rules under s CQ 5(1)(d)(ii) or (iii) or s CQ 5(1)(e)(ii) or (iii).
- The New Zealand investor can adopt and chooses to adopt the attributable FIF income method for calculating FIF income.
- The exemption for a non-attributing active FIF in s CQ 5(1)(c)(xv) does not apply to the New Zealand investor.
- The US LLC makes a distribution to the New Zealand investor.
- The US LLC withholds US federal income tax and pays it on the New Zealand investor's partnership income on the investor's behalf.
- No US federal income tax is payable on the distribution from the US LLC to the New Zealand 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.
- All amounts are expressed in New Zealand dollars.

This Ruling does not consider the tax implications of any indirect FIF interests held by a New Zealand investor via their interest in the US LLC.

For the purposes of this Ruling, the term:

- "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;
- "FIF" means a FIF 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; and
- "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.

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

## How the taxation laws apply to the Arrangement | Ko te pānga o ngā ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- The New Zealand investor will be subject to New Zealand tax on the attributed income from their interest in the FIF under ss CQ 4, CQ 5, CQ 6, EX 44(1)(b) and EX 50.
- US federal income tax paid for the New Zealand investor on their partnership income is creditable against the New Zealand investor's FIF attributed income tax liability under s LK 1(1)(d). However, this is only to the extent that it does not exceed the New Zealand tax payable on the FIF attributed income and the tax credit only relates to foreign tax paid in relation to income that is attributed FIF income.
- The distribution from the US LLC to the New Zealand investor will be a dividend and therefore income under s CD 1.
- Where the New Zealand investor is a company, any dividends it derives from a foreign company are exempt income under s CW 9 unless subs (2) or (3) of s CW 9 applies.
- Where the New Zealand investor is a natural person, they may reduce their dividend income under s CD 1 by the amount of the US federal income tax paid on their partnership income under s CD 18. The amount of the reduction is calculated using the formula in s CD 18(2). This formula takes into account the total federal income tax paid on the US LLC interest since acquiring it, any refund, and the amounts of such tax that have already reduced other dividends of the New Zealand investor in accordance with s CD 18.
- An individual New Zealand 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 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 reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

## The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply for the period beginning 26 June 2023 and ending 5 years from that date.

This Ruling is signed by me on 24 July 2023.

**Rhonda Gregory**

Senior Tax Counsel, Tax Counsel Office | Rōia Tāke, Te Tari Tohutohu Tāke

# Public Ruling BR Pub 23/12: Income tax – Attributed controlled foreign company income and dividends 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 | Ture tāke

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

This Ruling applies in respect of sections CD 1, CD 3, CD 18, CQ 1, CQ 2, CW 9, EX 1, EX 14, EX 15, EX 16, EX 17, EX 21B, LK 1(1)(d), OE 1(2) and OE 20, and the Double Taxation Relief (United States of America) Order 1983.

## The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is as follows:

- A New Zealand investor is one of the members of a United States limited liability company (US LLC) that has not elected to be taxed as a corporation in the US and their interest is in a controlled foreign company (CFC).
- The New Zealand investor has an income interest of 10% or more in the US LLC under ss EX 14 to EX 17.
- The CFC is not a non-attributing active CFC under ss CQ 2(1)(h) and EX 21B.
- Where the New Zealand investor is a natural person, they are not a transitional resident.
- The US LLC makes a distribution to the New Zealand investor.
- The US LLC withholds US federal income tax and pays it on the New Zealand investor's share of partnership income on the investor's behalf.
- 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.

This Ruling does not consider the tax implications of any indirect foreign investment fund (FIF) interests held by a New Zealand investor via their interest in the US LLC.

For the purposes of this Ruling, the term:

- "CFC" means a CFC 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;
- "FIF" means a FIF 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; and
- "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.

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

## How the taxation laws apply to the Arrangement | Ko te pānga o ngā ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- The New Zealand investor will be subject to 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 New Zealand investor on their partnership income is creditable against the New Zealand investor's CFC attributed income tax liability in terms of s 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 tax credit only relates to foreign tax paid in relation to income that is attributed CFC income.
- The distribution from the US LLC to the New Zealand investor will be a dividend and therefore income under s CD 1.
- Where the New Zealand investor is a company, any dividends it derives from a foreign company are exempt income under s CW 9 unless subs (2) or (3) of s CW 9 applies.
- Where the New Zealand investor is a natural person, they may reduce their dividend income under s CD 1 by the amount of the US federal income tax paid on their partnership income under s CD 18. The amount of the reduction is calculated using the formula in s CD 18(2). This formula takes into account the total federal income tax paid on the US LLC interest since acquiring it, any refund, and the amounts of such tax that have already reduced other dividends of the New Zealand investor in accordance with s CD 18.
- An individual New Zealand 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 CFC income) against the New Zealand tax liability on the reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

## The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply for the period beginning 26 June 2023 and ending 5 years from that date.

This Ruling is signed by me on 24 July 2023.

**Rhonda Gregory**

Senior Tax Counsel, Tax Counsel Office | Rōia Tāke, Te Tari Tohutohu Tāke

# Public Ruling BR Pub 23/13: Income tax – 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 non-attributing active controlled foreign company

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

## Taxation laws | Ture tāke

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

This Ruling applies in respect of ss CD 1, CD 3, CD 18, CW 9, CQ 2(1)(h), CQ 5(1)(c)(xv), EX 1, EX 28, EX 50, LJ 1(1) and LJ 2(1), and the Double Taxation Relief (United States of America) Order 1983.

## The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is as follows:

- A New Zealand investor is one of the members of a United States limited liability company (US LLC) that has not elected to be taxed as a corporation in the US and their interest is in a non-attributing active foreign investment fund (FIF) or a non-attributing active controlled foreign company (CFC).
- Where the New Zealand investor is a natural person, they are not a transitional resident.
- The US LLC makes a distribution to the New Zealand investor.
- The US LLC withholds US federal income tax and pays it on the New Zealand investor's partnership income on the investor's behalf.
- 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.

This Ruling does not consider the tax implications of any indirect FIF interests held by a New Zealand investor via their interest in the US LLC.

For the purposes of this Ruling, the term:

- "CFC" means a CFC 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;
- "FIF" means a FIF 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 non-attributing active FIF interest under ss CQ 5(1)(c)(xv), EX 21B and EX 50, 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; and
- "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.

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

## How the taxation laws apply to the Arrangement | Ko te pānga o ngā ture tāke ki te Whakaritenga

The taxation laws apply to the Arrangement as follows:

- The New Zealand investor will not have attributed income for either FIF or CFC purposes under ss CQ 5(1) or CQ 2(1), due to ss CQ 5(1)(c)(xv) or CQ 2(1)(h) respectively.
- The distribution from the US LLC to the New Zealand investor will be a dividend and therefore income under s CD 1.
- Where the New Zealand investor is a company, any dividends it derives from a foreign company are exempt income under s CW 9 unless subs (2) or (3) of s CW 9 applies.
- Where the New Zealand investor is a natural person, they may reduce their dividend income under s CD 1 by the amount of the US federal income tax paid on their partnership income under s CD 18. The amount of the reduction is calculated using the formula in s CD 18(2). This formula takes into account the total federal income tax paid on the US LLC interest since acquiring it, any refund, and the amounts of such tax that have already reduced other dividends of the New Zealand investor in accordance with s CD 18.
- The New Zealand 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 there is no attributed FIF or CFC income for the income year, no branch equivalent tax account credit is available for that year.

## The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply for the period beginning 26 June 2023 and ending 5 years from that date.

This Ruling is signed by me on 24 July 2023.

**Rhonda Gregory**

Senior Tax Counsel, Tax Counsel Office | Rōia Tāke, Te Tari Tohutohu Tāke

# Commentary on Public Ruling | Takinga kōrero o ngā Whakatau Tūmatanui BR Pub 23/09 – 23/13

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 23/09 – 23/13 (the Rulings).

## Summary | Whakarāpopoto

1. This commentary explains the income tax treatment for a New Zealand investor in a United States limited liability company (US LLC) and the circumstances when a foreign tax credit (FTC) or other relief is available for US federal income tax that they pay on their "distributive share" of the US LLC's income. This depends on whether the US LLC is a foreign investment fund (FIF) or a controlled foreign company (CFC), and if the US LLC pays a dividend to the New Zealand investor.
2. By way of background, a US LLC is a hybrid entity[1] formed in the US that has company and partnership characteristics. A US LLC is a company that members form to hold business assets and conduct a specific business, and provides limited liability to its members. These Rulings focus on US LLCs that are treated as a partnership, where its members are taxed as partners for US federal income tax purposes.
3. 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.
4. The Rulings set out that the income tax treatment for a New Zealand investor in a US LLC can vary depending on who holds the interest, whether the New Zealand investor's FIF interests are under the FIF threshold, the choice of calculation method, and whether the US LLC is classified as a FIF, a CFC, or a non-attributing active FIF or CFC.
5. A New Zealand investor is entitled to claim a New Zealand FTC for US federal income tax they pay and/or "relief" in terms of s CD 18, s EX 51, subpart LK or subpart OE in the three circumstances set out in the Rulings.
6. The first circumstance is where the US LLC is a CFC or a FIF (where the investor chooses to adopt the attributable FIF income method) and the New Zealand investor has attributed CFC or FIF income. The New Zealand investor may claim an FTC under subpart LK 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. Where the New Zealand investor is an individual, they may also claim a branch equivalent tax account (BETA) tax credit under subpart OE (for New Zealand tax paid on attributed CFC or FIF income) against their tax liability on dividend income.
7. The second circumstance is where the New Zealand investor derives a dividend from the US LLC. The New Zealand investor may reduce the amount of the dividend by any US federal income tax they paid on their distributive share of the US LLC's income under s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend amount. Where the New Zealand investor is not subject to New Zealand tax on the dividend from the US LLC, the relief under CD 18 does not apply because the dividend is not taxable. This will be the case if the New Zealand investor is a company and the foreign dividends it derives are exempt income under s CW 9 (provided subss (2) and (3) of s CW 9 do not apply), and where the New Zealand investor chooses to adopt one of the following FIF income calculation methods: fair dividend rate, comparative value, cost method or deemed rate of return.
8. The third circumstance is where the New Zealand investor chooses to adopt 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 a reduction of the closing value in the formula in s EX 51(1).
9. A New Zealand investor may also be entitled to relief under the Double Taxation Relief (United States of America) Order 1983 (NZ–US DTA). However, under the specific facts of the arrangements these Rulings cover, the articles in the NZ–US DTA dealing specifically with relief from double taxation do not apply to provide any relief for dividend income derived from a US LLC. For completeness, we note the NZ–US DTA does not impact on the circumstances for which relief is available under s CD 18, s EX 51, subpart LK or subpart OE in the three circumstances discussed at [6] to [8].

1 US LLCs do not satisfy the definition of a "hybrid entity" for the purposes of the hybrid mismatch rules in subpart FH. While US LLCs may be reverse hybrid entities, the provisions in subpart FH are not expressly relevant in the context of the Rulings.

10. The Rulings outline when tax relief is available to individual investors under s CD 18 and subpart OE (as discussed at [6] and [7]). While this relief may also apply to other investors that are not companies or individuals, the Rulings and commentary do not specifically consider how the taxation laws could apply to such persons.

## Background | Horopaki

11. BR Pub 23/09 – 23/13 is a reissue of BR Pub 20/01 – 20/05, which expired on 25 June 2023. The Rulings apply from 26 June 2023 to 25 June 2028. The Commissioner's view remains unchanged from when BR Pub 20/01 – 20/05 was published.
12. In this commentary, we discuss:
    12.1 what a US LLC is (from [14]);
    12.2 the characteristics of a US LLC that make it a company for New Zealand tax purposes (from [24]);
    12.3 why a US LLC is not a partnership for New Zealand tax purposes (from [29]);
    12.4 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 [32]);
    12.5 how a New Zealand resident investor is taxed on income derived from a US LLC (from [35]);
    12.6 what foreign taxes that a New Zealand investor pays in respect of a US LLC are creditable against the investor's income (from [91]);
    12.7 how s CD 18 applies to investments in a US LLC (from [111]);
    12.8 how subpart OE (branch equivalent tax accounts) applies to individual investors in a US LLC (from [116]); and
    12.9 the NZ–US DTA in respect of an investment in a US LLC (from [122]).
13. Examples following [136] outline a range of different circumstances and the tax consequences of each one. An Appendix after the references contains flow charts showing how to work out which ruling applies and providing an overview of the tax treatment of income derived. It also includes tables setting out the tax treatment for FIFs and CFCs.

## What is a US LLC?

14. A US LLC is a hybrid legal entity that is a limited liability company but also has characteristics of a partnership.[2] US LLCs are established at the state level under local state law but are similar in structure across the US.
15. US LLCs have four common features:
    15.1 The US LLC is a separate legal entity from its members.
    15.2 The US LLC, not its members, conducts the business of the US LLC.
    15.3 The US LLC, not its members, owns the assets used for carrying on the business of the US LLC.
    15.4 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.
16. The operations of a US LLC are generally governed by an operating agreement. Most operating agreements include an explanation of:
    16.1 each member's percentage interest in the US LLC represented by their capital account;
    16.2 the members' rights and responsibilities;
    16.3 how the US LLC will be managed;
    16.4 dissolution procedures;

2 US LLCs with two or more members are taxed as partnerships by default unless they elect to be taxed as a corporation. 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 approach to allocating the US LLC's profits to its members and crediting profits to their capital account is similar to how profits are allocated and accounted for in a partnership.

Single-member US LLCs are also taxed on a flow through basis to that member. While the Rulings do not apply to single-member US LLCs, the discussion in this Commentary on the tax outcomes arising could also apply in certain circumstances to single-member LLCs that do not elect to be taxed as a corporation and are taxed with a flow-through treatment. Different outcomes may arise, for example, if the US LLC's operating agreement contains terms that impact the timing of income derivation.

16.5 how profits and losses for financial accounting and tax are to be allocated to each member; and

16.6 rules governing what distribution of a member's share of the US LLC's profits is to be made in a particular year.

17. 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.

18. Ownership in a US LLC is represented by a membership interest rather than by shares. For this reason, a US LLC's owners are referred to as members rather than shareholders.

19. 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.

20. 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 may be.

21. 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.

22. For US federal income tax purposes, a US LLC with multiple members is treated and taxed as a partnership unless it elects to be taxed as a corporation.[3] Each member of a US LLC pays tax on their distributive share of the US LLC's income, which they report on their individual US federal income tax return.[4] The US LLC files a federal partnership return, and the individual member must include their distributive share in their personal federal income tax return.[5]

23. A US LLC is required to withhold and pay tax from US-sourced profits allocated to non-resident members on the members' behalf. Different rates apply depending on the income category but commonly 30% applies. 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 and paid by the US LLC on behalf of the investor.

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

24. The word "company" is defined in s YA 1. Company (in part):

> **YA 1 Definitions**
>
> In this Act, unless the context requires otherwise,— …
>
> ***company***—
>
> (a) means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere:
>
> (ab) does not include a partnership:

25. 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.

3 *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.

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

5 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, not the partnership, who are liable for income tax: § 701 of the Internal Revenue Code (US).

(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) 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.

26. A US LLC meets the definition of a company for New Zealand company and tax law purposes for six main reasons:

26.1 A US LLC is a legal entity that comes into existence by the execution of a certificate of formation.[6] It remains in existence until it is dissolved.

26.2 The assets used for carrying on the business of the US LLC belong to the US LLC, not its members.[7]

26.3 The US LLC (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.

26.4 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.[8]

26.5 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.

26.6 Fees and formalities need to be paid and satisfied to create a US LLC in the US.

27. 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" (s YA 1).

28. 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

29. Section YA 1 provides that a company does not include a partnership.

30. A "partnership" is defined in s YA 1 to mean a group of 2 or more persons who have between themselves the relationship described in s 8(1) of the Partnership Law Act 2019. Section 8 of the Partnership Law Act 2019 defines a partnership as the relationship that "exists between persons carrying on a business in common with a view to profit".

31. A US LLC is not a partnership for New Zealand tax purposes because it is the US LLC that carries on the business, 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

32. 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".

6 For example, § 18-201 of the Limited Liability Company 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.

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

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

33. 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. For this reason, for New Zealand tax purposes 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 it conducts (that is, the income will not be treated as derived by the members of the US LLC).

34. 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

35. A New Zealand investor in a US LLC may 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.

36. In the following paragraphs, we discuss:

    36.1 what a dividend is for New Zealand tax purposes (from [37]);

    36.2 when a dividend is derived for New Zealand tax purposes (from [42]);

    36.3 what a dividend is in the US LLC context (from [44]);

    36.4 how the FIF regime applies to investments in a US LLC (from [53]); and

    36.5 how the CFC regime applies to investments in a US LLC (from [80]).

### What a dividend is for New Zealand tax purposes

37. Section CD 1(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.

38. 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.

39. 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.

40. 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.

41. 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

42. A dividend is not income of a person unless it is also derived by that person for New Zealand tax purposes. A dividend is derived when the income is credited to a taxpayer's account or in some other way dealt with in their interest or on their behalf, regardless of whether the New Zealand investor is a cash-basis or an accruals-basis taxpayer, even if it is not treated as derived by them under common law: s BD 3(4).

43. The arrangements to which these Rulings apply assume that the only dividends derived from a US LLC are cash dividends (a dividend other than a non-cash dividend). Section CD 1(2) confirms that income from cash dividends is allocated to the income year it is received. This includes where the dividend is credited to the balance of the person's current or other account with the entity.

### What a dividend is in the US LLC context

44. 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.[9] 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.

45. 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.

46. 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.

47. 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 another 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.

48. 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.

49. The timing is different 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. In this case, the member will derive the dividend for New Zealand tax purposes at the time of crediting to their capital account. Example 2 and Example 3 (following [136]) explain the practical effects of this difference.

50. 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* from those in *Alliance Group Ltd v CIR* (1995) 17 NZTC 12,066, where the High Court had concluded that a payment had not happened 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.

9 Where there is no term in the operating agreement or no operating agreement exists, 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 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.

51. 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 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.

52. 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, New Zealand's FTC rules and s CD 18 are discussed next.

## How the FIF regime applies to investments in a US LLC

53. An investment in a US LLC by a New Zealand investor will be an investment in a FIF (unless it is a CFC in which the investor's income interest is 10% or more) and the FIF rules will apply.

54. Section EX 28 defines a FIF as including a "foreign company". As discussed at [24], 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.

55. 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 applies. 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.

56. 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.

57. 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.

58. 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 applies (unless it is a CFC in which the investor's income interest is 10% or more, where the CFC rules will apply instead). Similarly, it is assumed that the member is not a transitional resident who is not taxed in New Zealand on certain foreign-sourced income.

59. The FIF rules apply to the following arrangements, as set out in the Rulings.

### Where total cost of the investor's interests in FIFs is $50,000 or less

60. 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) and (e) respectively.[10] 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) and does not have FIF income under s CQ 5(1) where the circumstances in s CQ 5(1)(d) and (e) do not apply.
61. Section CD 18 applies to reduce the amount of a dividend derived from the US LLC to take into account US federal income tax paid by the New Zealand investor. The amount of the reduction is calculated using the formula in s CD 18(2). This formula requires factoring in any prior reductions to other dividends for US federal tax in accordance with s CD 18 since inception of the investment in the US LLC. This is explained in more detail from [111].
62. 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.
63. 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 reduction has a similar overall effect, albeit as a different way of recognising the US tax paid by the New Zealand investor. Example 2 and Example 3 (following [136]) illustrate how this works in practice.

### 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

64. Where the $50,000 FIF "exemption" does not apply, a New Zealand investor who has an attributing interest must pay New Zealand tax on their FIF income. Subject to any limitations under s EX 44(2), a New Zealand investor may choose one of the following five methods for calculating FIF income:[11]
    64.1 fair dividend rate (FDR);
    64.2 comparative value (CV);
    64.3 cost method (CM);
    64.4 deemed rate of return (DRR); and
    64.5 attributable FIF income method (AFIM – covered in the next section).
65. Where a New Zealand investor in a US LLC chooses to adopt 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 chooses to adopt the FDR, CV, CM or DRR calculation method is excluded income under ss EX 59(2) and CX 57B (that is, it is not assessable income).



10 If the person is a trustee, they must also meet the requirements of s CQ 5(5), which broadly restrict eligibility to testamentary trusts of a person within 5 years of death, certain court-ordered trusts and trusts settled by the Accident Compensation Corporation.

11 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. In choosing a calculation method, New Zealand investors should also consider any data requirements for the calculation, including practicalities around determining the market value of their interests.

66. Additionally, s CD 36 provides that where a person adopts the FDR, CV, CM or DRR calculation method, 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).

67. As s CD 36 excludes an amount derived from a foreign company from being a dividend, s CD 18 does not apply to a New Zealand investor in a FIF who adopts the FDR, CV, CM or DRR calculation method. Section CD 18 provides relief for New Zealand investors in foreign hybrid entities by allowing the amount of a dividend to be reduced for foreign tax paid; s CD 18 cannot apply if there is no dividend (which is the effect of s CD 36).

68. Also, a New Zealand investor cannot claim a New Zealand FTC (under subpart LJ or the NZ–US DTA) for US federal income tax on their distributive share against their New Zealand tax liability on FIF income. This is because the US federal income tax paid on the New Zealand investor's distributive share is not foreign tax paid on FIF income.

69. For a detailed example, see Example 4 (following [136]).

70. However, relief is available for US federal income tax paid on a New Zealand investor's distributive share if that investor has chosen to adopt the CV method to calculate their FIF income. Section EX 51(1) provides a formula for calculating CV income. A New Zealand investor 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). The amount is also a "gain" under s EX 51(4) and a reduction in the "closing value" under s EX 51(3) in the formula. The overall net result is a reduction in FIF income as calculated under s EX 51(1) by the amount of the US federal income tax paid.

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

71. In general terms, a New Zealand investor in a FIF may choose to adopt the AFIM for calculating their FIF income, provided the New Zealand investor can give the Commissioner (if requested) sufficient information to enable the Commissioner to check the calculations required by s EX 50; and where:

    71.1 the FIF is a foreign company and the New Zealand investor:

    71.1.1 has an income interest of 10% or more in the FIF; and

    71.1.2 is not a portfolio investment entity; or

    71.2 the FIF 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).

72. 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 (unless it is a non-attributing active FIF as discussed below).

73. The New Zealand investor is taxed on their share of the FIF's income under ss CQ 4, CQ 5, CQ 6, EX 44(1)(b) and EX 50.

74. 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 tax credit is only available to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and it only relates to foreign tax paid in relation to income that is attributed FIF income.]

75. A distribution from the US LLC is a dividend and will therefore be income under s CD 1 for New Zealand tax purposes. The New Zealand tax consequences of the dividend distribution are as follows:

    75.1 Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income under s CW 9 provided the exclusions in s CW 9(2) and (3) do not apply. No FTCs are claimable.

    75.2 Where the New Zealand investor is an individual, they may reduce the amount of the dividend they derive from the US LLC by the amount of US federal income tax they paid on their distributive share of the US LLC's income: s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend.

    75.3 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 reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

76. For a detailed example, see Example 5 (following [136]).

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

77. 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 reduce the amount of the dividend derived from the US LLC by the amount of any US federal income tax paid on their distributive share of the US LLC's income: s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend.

78. On the other hand, a New Zealand company investor is not subject to New Zealand tax because dividends from a foreign company are exempt income under s CW 9, provided the exclusions in s CW 9(2) and (3) do not apply.

79. For a detailed example, see Example 7 (following [136]).

## How the CFC regime applies to investments in a US LLC

80. 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.

81. 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.

82. 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

83. In summary, the New Zealand tax consequences for a US LLC that is a CFC are as follows (which are the same as the tax consequences for a New Zealand investor in a FIF where the investor chooses to adopt the AFIM):

    83.1 The New Zealand investor pays New Zealand tax on their share of attributed CFC income under ss CQ 1 and CQ 2.

    83.2 Any US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income is creditable against their CFC attributed income tax liability: s LK 1(1)(d). Note that this tax credit is available only to the extent it does not exceed the New Zealand tax payable on the CFC attributed income and it only relates to foreign tax paid in relation to income that is attributed CFC income.

    83.3 A distribution from the US LLC is a dividend and will therefore be income under s CD 1 for New Zealand tax purposes. The New Zealand tax consequences of the dividend distribution are as follows:

        83.3.1 Where the New Zealand investor is a company, any dividends derived by the company from a foreign company are exempt income under s CW 9, provided the exclusions in s CW 9(2) and (3) do not apply. No FTCs are claimable.

        83.3.2 Where the investor is an individual, they may reduce the amount of the dividend they derived from the US LLC by the amount of US federal income tax they paid on their distributive share of the US LLC's income: s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend.

83.3.3 An individual 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 CFC 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 CFC income) against the New Zealand tax liability on the reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

84. For a detailed example, see Example 6 (following [136]).

**Where the US LLC is a non-attributing active CFC**

85. Where the US LLC is a non-attributing active CFC, then the tax consequences are the same as described at [77] to [79] for a non-attributing active FIF.

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

87. A dividend is income under s CD 1. A New Zealand investor is subject to New Zealand tax only on dividends derived from the US LLC as follows:

87.1 Where the investor is a company, any dividends derived by the company from a foreign company are exempt income under s CW 9, provided the exclusions in s CW 9(2) and (3) do not apply. No FTCs are claimable.

87.2 Where the investor is an individual, they may reduce the amount of the dividend they derived from the US LLC by the amount of US federal income tax they paid on their distributive share of the US LLC's income: s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend.

88. For a detailed example, see Example 7 (following [136]).

### Additional FIF income on indirect FIF interests where the US LLC is a CFC, or a FIF where the investor adopts the AFIM

89. For completeness, where a US LLC holds FIF interests and the US LLC is a CFC, or a FIF where the AFIM is adopted, additional FIF income (or loss) may arise for a New Zealand investor under ss EX 58 or EX 50(6). The additional FIF income or loss can arise regardless of whether or not the US LLC is a non-attributing active FIF or CFC.

90. The Rulings and commentary do not specifically consider the tax implications of any indirect FIF interests held by a New Zealand investor via their interest in a US LLC. This is because additional FIF income or loss may arise in respect of an indirect FIF interest regardless of whether the interest is held via a US LLC or not. In other words, the tax implications of such indirect holdings in FIFs are not specific to the taxation of US LLCs and are out of scope of the Rulings and commentary.

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

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

91.1 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.

91.2 Section LJ 2(6) and (7) sets out a special rule for claiming an FTC where the New Zealand investor adopts the FDR, CV, CM or DRR FIF income calculation method. A New Zealand investor may claim foreign tax paid on actual foreign-sourced dividends against the New Zealand tax liability on the FIF income they derived.

91.3 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

92. 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. These sections also set out how to calculate the New Zealand tax applicable on that foreign-sourced income.

93. Section LJ 1(1) and (2)(a) provides:

> **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]

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

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

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

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

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

98. 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.

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

100. We consider how the NZ–US DTA applies for US LLC investments from [122] to [130]. Article 22 of the NZ–US DTA operates in essentially the same way as ss LJ 1(1) and LJ 2(1) by permitting an FTC for foreign tax paid but only on the same income, for example, a foreign-sourced dividend taxed in New Zealand and in the US.

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

101. 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).

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

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

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

## Subpart LK – CFC and FIF income

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

106. Section LK 1(1) provides:

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

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

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

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

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

## How s CD 18 applies to investments in a US LLC

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

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

112. Section CD 18 works to eliminate the over-taxation of dividends derived by a New Zealand investor in a hybrid entity such as a US LLC, so that the New Zealand investor is treated for New Zealand tax purposes as deriving the same amount of dividend income as a New Zealand investor in an ordinary (that is, non-hybrid) foreign company. This outcome is achieved by allowing a New Zealand investor in a foreign hybrid entity to reduce the amount of a dividend derived from the foreign hybrid entity by any foreign tax that the New Zealand investor pays (for example, as a "partner") on the foreign hybrid's income. Note that the provision only permits a reduction for tax actually paid by the time the dividend is derived. Unlike

subpart LK, it does not extend to "tax paid or payable" to cover any timing mismatches between New Zealand and the foreign jurisdiction. Also, any refunds of foreign tax received must reduce the amount available as a reduction under s CD 18. A New Zealand investor in a US LLC may receive a refund as a result of filing their required personal tax return in the US. For an illustration of the treatment of a tax refund, see Example 2 (following [136]).

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

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

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

This example assumes the following:

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

### New Zealand tax consequences

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

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

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

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

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

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

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

116. 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).
117. A BETA is available to an individual investor who has a net New Zealand tax liability (after FTCs have been applied) on their attributed CFC or FIF income. Its purpose is to enable such an investor to credit that amount to their BETA and to use this credit to satisfy any New Zealand tax liability payable on dividends derived from the FIF or CFC.
118. A BETA allows an individual investor to claim a tax credit (for tax that they pay on attributed CFC or FIF income) against their tax liability on dividend income, similar to the way an investor in a New Zealand resident company claims an imputation credit for underlying tax paid by the company. In both cases, the purpose of the credit is to avoid economic double taxation on the dividend derived by an individual investor.
119. A New Zealand resident company cannot maintain a BETA. However, as dividends it derives from a foreign company are exempt income under s CW 9 (assuming the exclusions in s CW 9(2) and (3) do not apply), economic double taxation does not arise.
120. 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.
121. 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

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

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

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

> In the case of New Zealand, double taxation shall be avoided as follows:
>
> In accordance with, and subject to any provisions of, the law of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax for tax paid in a country outside New Zealand (which shall not affect the general principle hereof), **United States tax paid under the law of the United States** and consistently with this Convention, whether directly or by deduction, **in respect of income derived by a resident of New Zealand arising in the United States** (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) **shall be allowed as a credit against New Zealand tax payable in respect of <u>that income</u>**; except that such credit shall not exceed the amount of the tax that would be paid to the United States if the resident were not a United States citizen or a United States company.
>
> …
>
> 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]

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

125. 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).

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

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

127. 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.

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

129. In the context of the Rulings, a New Zealand investor in a US LLC 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.[12]

130. Article 1(6) does not assist on the facts of the Rulings.

## Overseas authority

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

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

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

134. The Commissioner does not consider that the decision of the UK Supreme Court in *Anson* affects the analysis set out in this commentary. To determine how profit or income is to be taxed in New Zealand, the New Zealand legislative scheme requires an entity to be classified for New Zealand tax purposes. Based on the characteristics of a US LLC under US law, the Commissioner considers that a US LLC is a company because the legal characteristics of the US LLC meet the New Zealand

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

tax definition of "company"[13]. Accordingly, the New Zealand legislative scheme treats the US LLC as deriving the income from the conduct of its business (that is, the income is treated as derived by the US LLC, rather than by the members of the US LLC). Consequently, a New Zealand investor in a US LLC will be subject to New Zealand tax on distributions or dividends they derived from the US LLC and/or any FIF income or attributed CFC income, where the US LLC is a FIF or a CFC.

135. Section CD 18 is also an important feature of the scheme of the Act dealing with foreign hybrid entities. It deals explicitly with company–partnership foreign hybrids (US LLCs in this context) and the over-taxation of foreign source dividend income derived from a foreign hybrid entity. Section CD 18 permits a New Zealand investor in a foreign hybrid entity to reduce the amount of the dividend they derive from the foreign company by the foreign tax that they have paid. Section CD 18 is premised on the foreign hybrid entity (US LLC in this context) being a company that derives its own income and pays a dividend to its shareholder (even though it is taxed as a partnership in the foreign tax jurisdiction).

## Examples

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

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

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

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

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

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

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

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

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

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

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

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

136.12 Where the New Zealand investor is a natural person, it is assumed they have a marginal tax rate of 33%, are not a transitional resident, and have not opted into the FIF rules where the total cost of all FIF interests they hold are $50,000 or less.

136.13 All amounts are expressed in New Zealand dollars.

13 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.

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

**Circumstances**

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

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

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

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

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

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

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

**New Zealand tax consequences**

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

The total distribution of $1,000 (the $700 distribution and the $300 US federal income tax that the US LLC paid 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).

Section CD 18 applies to reduce the amount of the dividend by the US federal income tax paid by the New Zealand investor ($300) in year 1. In other words, the New Zealand investor's dividend 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 reduced 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 the future under s CD 18 from year 2 onwards.

The 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 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 and so is not tax paid on the relevant segment of foreign-sourced income.

**Example | Tauira 3: Individual New Zealand investor's investment in a US LLC is under the $50,000 FIF threshold and distributions are not mandatory**

**Circumstances**

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

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

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

**New Zealand tax consequences**

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

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

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

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

**Circumstances**

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

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

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

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

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

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

**New Zealand tax consequences**

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

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

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

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

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

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

**Circumstances**

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

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

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

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

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

**New Zealand tax consequences**

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

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

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

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

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

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

- Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income under s CW 9 (provided the exclusions in s CW 9(2) and (3) do not apply). No FTCs are claimable.
- If the New Zealand investor is an individual, they may reduce the amount of the dividend they derived from the US LLC ($2,030) by the US federal income tax paid on their share of the US LLC's income ($630): s CD 18. The New Zealand investor is subject to New Zealand tax on the reduced dividend (that is, net of foreign tax they paid in the US, which is $1,400).
- An individual New Zealand investor may choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming an FTC), then the individual investor may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the reduced dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.
- The individual New Zealand investor's net New Zealand tax liability after FTCs is $30 (the FIF income tax liability of $660 ($2,000 FIF income × 33% tax rate) less FTC $630 = $30). The investor may use the $30 as a BETA tax credit to satisfy any New Zealand tax liability on dividends they derived from the FIF.

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

**Circumstances**

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

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

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

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

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

**New Zealand tax consequences**

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

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

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

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

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

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

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

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

**Circumstances**

A New Zealand investor (company or individual) invests in a US LLC that is a non-attributing active FIF or CFC. The US LLC does not hold any FIF interests.

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

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

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

**New Zealand tax consequences**

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

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

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

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

## References | Tohutoro

### Legislative references | Tohutoro whakatureture

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, CD 4 to CD 6, CD 18, CD 36, CQ 1, CQ 2, CQ 4, CQ 5, CQ 6, CW 9, CX 57B, EX 1, EX 14 to EX 17, EX 21B, EX 28 to EX 44, EX 46, EX 50, EX 51, EX 59, subpart FH, HG 2, LJ 1, LJ 2, LJ 4, LK 1, LK 4, LK 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 Law Act 2019, s 8

Tax Administration Act 1994, s 93C

### Case references | Tohutoro kēhi

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

*Anson v Commissioners for HMRC* [2015] UKSC 44

*CIR v Albany Food Warehouse* [2009] 24 NZTC 23,532 (HC)

*Mills v Dowdall* [1983] NZLR 154 (CA)

### Other references | Tohutoro anō

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

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

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

## Appendix | Āpititanga

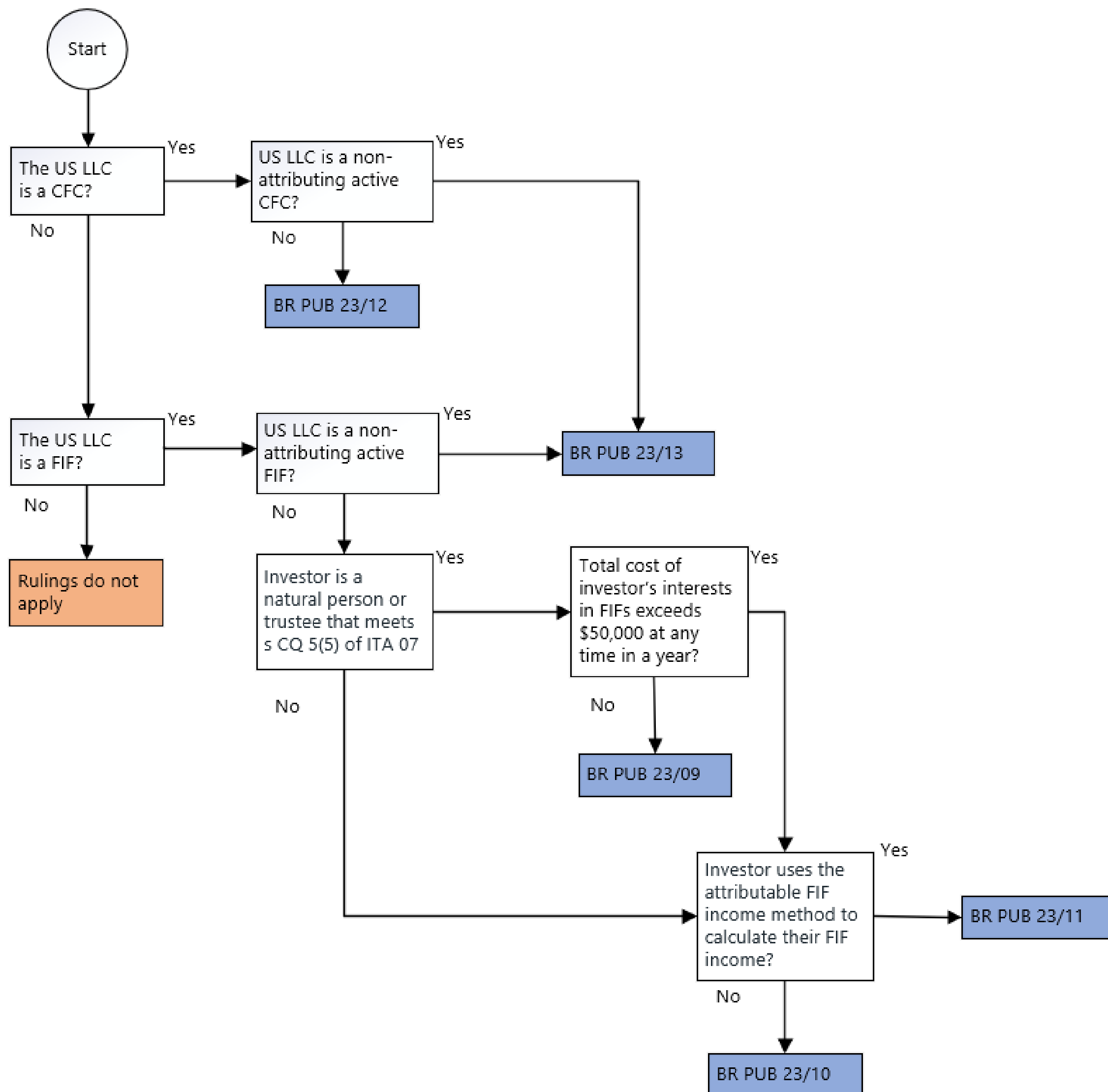
The flowchart and tables in this Appendix are intended to be an indicative tool only to be read in conjunction with the features of the arrangements as outlined in the Rulings.

Only the Public Rulings BR Pub 23/09 – 23/13 should be relied on as reflecting the Commissioner’s view on how the taxation laws apply.

**Abbreviations**

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

## Which Ruling may apply to my situation?



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

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

## FIF table

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

## CFC table

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

# QUESTION WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

## QB 23/07: GST - Directors and board members providing their services through a personal services company

Issued | Tukuna: 21 July 2023

This Question We've Been Asked considers the GST treatment of a director or board member who provides their services through a personal services company.

All legislative references are to the Goods and Services Tax Act 1985.

### Key provisions | Whakaratonga tāpua

Goods and Services Tax Act 1985 – section 6.

### Question | Pātai

**If a director[1] provides their services through a personal services company (PSC) will the PSC be able to register for GST when the director would not be able to register if they were providing their services in their capacity as a natural person?**

### Answer | Whakautu

**Yes. If the PSC contracts with the company requiring a director and supplies the services of the director under that contract, those supplies of directorship services are not excluded from the definition of "taxable activity" by section 6(3)(b) (or section 6(3)(c)(iii) for board members). This is because the supply by a PSC of a person to provide directorship services is distinct from the supply of those directorship services by an individual. As long as the PSC's level of activity is sufficient to be a taxable activity (as defined in section 6(1)) the PSC can register for GST.**

### Key terms | Kīanga tau tāpua

**Director**, in this item, includes "board members" (meaning people covered by section 6(3)(c)(iii)).

**Personal services company (PSC)** means a company a person has set up to provide services to clients. The person is often the only employee, shareholder, and director of the company.

### Explanation | Whakamāramatanga

1. On 22 February 2023, the Commissioner issued three public rulings relating to the GST treatment of directors' fees and board members' fees: BR Pub 23/01, BR Pub 23/02 and BR Pub 23/03).
2. One of the Commissioner's conclusions in the commentary to those rulings was that a professional director or board member (a person holding multiple directorships or board memberships) without any other associated taxable activity (such as a legal, accounting, or consulting practice) does not carry on a taxable activity just by virtue of holding multiple offices (Commentary on Public Rulings BR Pub 23/01–03). Each office is excluded from the definition of "taxable activity" by section 6(3)(b) or section 6(3)(c)(iii).
3. If the director or board member had an associated taxable activity they would be able to register for GST because of the effect of section 6(5). For a fuller explanation of these provisions, see Commentary on Public Rulings BR Pub 23/01–03, at [21] to [24] and Examples 1 and 2.

1 This item uses the term "directors" to also mean board members, because the treatment of the two groups is the same. Therefore, "directors" is used as an umbrella term for people covered by section 6(3)(c)(iii)).

4. We have been asked what happens where a director provides their services through a PSC.

## PSC contracts to provide a director's services

5. The situation the Commissioner considers has the most certain outcome is where the PSC contracts with the company that requires a director (the Company) for the provision of the director's services. In this situation, the services the PSC provides are not excluded by section 6(3)(b) because the PSC is not engaged as a director;[2] instead, it is supplying the services of a person to the Company to fulfil the director role.

6. As long as the PSC's supply of services is part of an activity that is carried on continuously and regularly involving the supply of goods and services, then the PSC is carrying on a taxable activity (as defined in section 6(1)), and the PSC can register for GST. This is consistent with the analysis in Commentary on Public Rulings BR Pub 23/01–03, at [33] to [36] and Example 5.

## Director contracts to provide their services to companies but is obliged to account for their fees to their PSC

7. A factual variation where the Commissioner considers the outcome less certain is where the director contracts directly with the Company to be a director but in circumstances where the director is obliged to account for the directorship fees to the PSC because the PSC is the employer of the director. In this situation, where the director enters the contracts directly with companies, section 6(3)(b) applies to exclude each office from the definition of "taxable activity" such that the director does not have a taxable activity relating to their services as a director.

8. Assuming the director is an employee of their PSC and is obliged to account to their employer PSC for fees received from the directorships, then section 6(4) applies. This provision means the accounting of fees to the employer is treated as consideration for a supply of services by the employer to the Company that made the payment to the director. This is consistent with Commentary on Public Rulings BR Pub 23/01–03, at [37] to [41] and Example 7.

9. Section 6(4) treats the employee's payment to the PSC as consideration for a supply of services by the PSC to the Company. It is not clear that when section 6(4) was enacted it was intended to allow an entity like a PSC to register for GST when it did not have a taxable activity independent of the deemed supplies under section 6(4). There are different views as to whether a court would find that section 6(4) applied in such a way that an entity without an independent taxable activity had a taxable activity solely on the basis of section 6(4) deemed supplies. This is because section 6(4) was intended to remove the previous asymmetry whereby a company paying fees directly to a director could not take a GST input tax deduction (because the director could not be a registered person and charge GST), but the employer of a director who received the fees had to pay GST output tax (see Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill: Commentary on the Bill, at 123–124).

10. In such circumstances, it is unclear whether a court would apply section 6(4) in such a way that a PSC would have a taxable activity just on the basis of the deemed supplies under section 6(4). The alternative approach would be that the PSC would simply not charge GST and the company would still not take an input tax deduction.

11. However, in circumstances where the director is employed by the PSC and is required to account to the PSC for directors' fees earned (due to the fiduciary obligations on them as an employee), the arrangement likely involves the PSC allowing their employee to act as a director. In effect, the PSC is supplying the services of the director but without the formal contractual relationship that was discussed at [5]. Provided the supply of services by the PSC is part of an activity that is carried on continuously and regularly involving the supply of goods and services, then the Commissioner is on balance satisfied that the PSC will be carrying on a taxable activity (as defined in section 6(1)) and the PSC can register for GST.

12. As discussed above, the GST treatment is more certain in cases where the PSC itself enters into contracts with a company for the provision of a director. This is illustrated in the Example | Tauira.

2 Indeed, they cannot be because a director must be a natural person.

**Example | Tauira: PSC contracts directly with company**

Rupert Barre is an independent director of Nutwood Forest Limited (NFL), a position that was entered into through his PSC, Rupert Barre Limited (RBL).

Rupert Barre is a well-respected public figure and proves to be an excellent director. Subsequently, RBL receives numerous requests for Rupert to join the boards of other companies. RBL enters into contracts with several other companies to provide Rupert Barre as a director.

NFL and the other companies agree to pay RBL for the provision of directorship services on the issue of an invoice by RBL.

Rupert now sits on the board of several companies, and those companies have board meetings at least every two months. RBL has been regularly entering into contracts with companies, invoicing for Rupert's services, dealing with enquiries from other companies interested in appointing Rupert as a director, paying Rupert a monthly salary, and dealing with all tax and other regulatory matters.

RBL's activity would be sufficient to amount to a taxable activity, so RBL can register for GST (and if RBL's level of supplies is over $60,000 per annum it must register for GST). Section 6(3)(b) does not exclude RBL's activity from being a taxable activity; it applies to exclude only the activity of Rupert Barre himself from the definition of "taxable activity".

## References | Tohutoro

### Legislative references | Tohutoro whakatureture

Goods and Services Tax Act 1985, section 6

### Other references | Tohutoro anō

BR Pub 23/01: Goods and services tax – directors' fees *Tax Information Bulletin* vol 35, no 3 (April 2023): 15
**www.taxtechnical.ird.govt.nz/tib/volume-35---2023/tib-vol35-no3**
**www.taxtechnical.ird.govt.nz/rulings/public/2023/br-pub-23-01---23-03**

BR Pub 23/02: Goods and services tax – fees of board members not appointed by the Governor-General or Governor-General in Council *Tax Information Bulletin* vol 35, no 3 (April 2023): 18
**www.taxtechnical.ird.govt.nz/tib/volume-35---2023/tib-vol35-no3**
**www.taxtechnical.ird.govt.nz/rulings/public/2023/br-pub-23-01---23-03**

BR Pub 23/03: Goods and services tax – fees of board members appointed by the Governor-General or Governor-General in Council *Tax Information Bulletin* vol 35, no 3 (April 2023): 21
**www.taxtechnical.ird.govt.nz/tib/volume-35---2023/tib-vol35-no3**
**www.taxtechnical.ird.govt.nz/rulings/public/2023/br-pub-23-01---23-03**

Commentary on Public Rulings BR Pub 23/01–03 *Tax Information Bulletin* vol 35, no 3 (April 2023): 23
**www.taxtechnical.ird.govt.nz/tib/volume-35---2023/tib-vol35-no3**
**www.taxtechnical.ird.govt.nz/rulings/public/2023/br-pub-23-01---23-03**

Minister of Revenue, *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill: Commentary on the Bill* (Inland Revenue, November 2013)
**www.taxpolicy.ird.govt.nz/publications/2013/2013-commentary-arearm**

# TECHNICAL DECISION SUMMARIES

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS is made available for information only and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs**. It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

## TDS 23/10: Distributions from private foundation on dissolution

Decision date | Rā o te Whakatau: 27 March 2023

Issue date | Rā Tuku: 11 July 2023

### Subject | Kaupapa

Whether the distributions by a private foundation on dissolution are taxable in the hands of a New Zealand resident taxpayer.

### Taxation laws | Ture tāke

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

### Facts | Meka

1. The Taxpayer is a New Zealand income tax resident.
2. In the early 2000s, the Taxpayer contributed funds to a Stichting Particulier Fonds (private foundation) established in, what was then, the Netherlands Antilles.
3. Under its articles, the private foundation was managed by a management board which, in turn, was supervised by a supervisory board. The private foundation's articles also regulate the appointment and dismissal of the members of the boards.
4. On incorporation, the registered office of the private foundation was in the Netherlands Antilles and the sole director of the private foundation was a limited liability company established in Curacao.
5. The private foundation was established with a small initial capital contribution, followed by an additional capital contribution of the funds mentioned above. Further capital contributions were made by the Taxpayer in subsequent years.
6. The capital contributed by the Taxpayer to the private foundation was in the nature of a gift.
7. The private foundation's purpose, as stated in its articles, is to make distributions from its assets to such institutions and persons as the board of directors shall decide, to render financial support to those institutions and persons by giving them loans, guarantees and through annuity agreements and similar arrangements.
8. The private foundation had previously distributed amounts to persons including the Taxpayer. The ruling did not consider or rule on:
   - The tax treatment of amounts that were distributed by the private foundation to the Taxpayer prior to the date a resolution was made to dissolve the private foundation.
   - The application of subpart CQ.
9. The management board of the private foundation wished to dissolve the private foundation due to changes in overseas law around foundation structures, and distribute funds to the Taxpayer.

## Issues | Take

10. The Tax Counsel Office (TCO) considered the following issues:
    - Whether the distribution of an amount from the private foundation on dissolution to the Taxpayer is income under s CD 1.
    - Whether the distribution of an amount from the private foundation on dissolution to the Taxpayer is income under s CV 13 or an amount to which s BF 1(b) applies.
    - Whether the distribution of an amount from the private foundation on dissolution to the Taxpayer is income under s CA 1(2).

## Decisions | Whakatau

11. TCO concluded that:
    - The private foundation was a "company" as defined in s YA 1.
    - The Taxpayer was a "shareholder" as defined in s YA 1 in the private foundation at the time of the distribution of an amount from the private foundation on dissolution.
    - The distribution of an amount from the private foundation on dissolution to the Taxpayer is not income of the Taxpayer under s CD 1 to the extent it does not exceed the Taxpayer's share of the "available capital distribution amount" calculated under s CD 44.
    - The distribution of an amount from the private foundation on dissolution to the Taxpayer is not income of the Taxpayer under s CV 13 or an amount to which s BF 1(b) applies.
    - The distribution of an amount from the private foundation on dissolution to the Taxpayer is not income of the Taxpayer under s CA 1(2).
12. The following conditions apply to TCO's conclusion:
    - The Taxpayer had no legal or equitable claim to the private foundation's assets before dissolution.
    - The management board resolved to dissolve the private foundation in accordance with its articles and that amounts distributed by the private foundation to the Taxpayer were distributed after the resolution to dissolve the private foundation had been approved.

## Reasons for decisions | Pūnga o ngā whakatau

### Issue 1 | Take tuatahi: Is the distribution income from a trust?

13. The Taxpayer requested the Commissioner to rule that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CV 13 or an amount to which s BF 1(b) applied.
14. Sections CV 13 and BF 1(b) apply to amounts derived from a "trust". It follows that the question considered by TCO was whether the private foundation should be characterised as a trust for New Zealand tax purposes.
15. When determining the application of the New Zealand tax legislation to an arrangement to which the laws of a foreign jurisdiction apply, TCO considered that a two-step approach was required:
    - The first step was to determine the legal rights and obligations that existed between the parties. The contractual arrangements and foreign law were used to determine those legal rights and obligations.
    - The second step was to consider the application of the New Zealand law contained in the Act to those legal rights and obligations. The foreign law was irrelevant at this stage.
16. In other words, TCO considered that the issue was not whether a trust relationship existed under the foreign law. The issue was whether the legal rights and obligations as determined under the foreign law would, when applied to the New Zealand context, be viewed as a trust. Whether the foreign law would consider that there was a trust was irrelevant. Under New Zealand law the nomenclature used was irrelevant, including any nomenclature used in the foreign jurisdiction.
17. TCO noted that this two-step approach was consistent with the approached outlined by the Commissioner in IS 19/04 *Income Tax – Distributions from foreign trusts* (IS 19/04) in relation to the issue of how to determine whether an arrangement is a "trust" for NZ purposes.

### Step One – The legal rights and obligations created under the foreign law

18. The first step was to determine the legal rights and obligations that exist between the parties. In this case the private foundations articles and the foreign law were used to determine those legal rights and obligations.
19. TCO was satisfied that the legal rights and obligations of the private foundation under the foreign law could be summarised as follows:
    - The private foundation was a legal person.
    - The private foundation had no members or shareholders.
    - The private foundation continued in perpetuity until such time as it was dissolved.
    - The private foundation owned the foundation's assets and could deal with the property on its own account.
    - The management board members were accountable to the stated purpose of the private foundation. The supervisory board supervises the board and has powers to provide prior consent in relation to important decisions.
    - There may be persons (the Taxpayer and their family) that could expect distributions to be made to them but they did not have any enforceable claim to a distribution of the private foundation's assets.

### Step Two - Application of the New Zealand law to the private foundation's rights and obligations

20. The question at step two was whether the legal rights and obligations of the private foundation as determined under the foreign law would, when applied to the New Zealand context, be viewed as a trust.
21. An essential feature of a trust for New Zealand purposes is the existence of an obligation (fiduciary duty) on a person (the trustee) to deal with the property for the benefit of the beneficiaries or a charitable purpose.[1] TCO considered the private foundation lacked this essential feature and therefore was not a trust, nor was there a trust relationship between the parties. The reasons for TCO's conclusion were as follows:
    - Legally the private foundation owned the assets in its own right and could deal with the property on its own account.
    - While the Taxpayer could expect distributions from the private foundation of its assets, the Taxpayer had no legal or equitable claim to the private foundation's assets.
    - The articles provided for the management board to decide on the time of any distribution from the private foundation and stated that a beneficiary was only a beneficiary and had no right whatsoever to claim a distribution.
    - The Taxpayer, as founder, had no enforceable claim to the private foundation's assets (including the capital contributed by the Taxpayer). The Taxpayer's capital contributions to the private foundation were in the nature of a gift.
    - The nomenclature used was irrelevant, including any nomenclature used in the foreign jurisdiction. That the articles of the private foundation referred to "beneficiaries" and some of the documents provided by the Taxpayer referred to the private foundation as a "trust", the management board as "trustees" and to "beneficiaries" did not result in the private foundation being characterised as a trust for New Zealand tax purposes.
22. The fact that the Taxpayer had no legal or equitable claim to the private foundation's assets before dissolution was crucial to TCO's conclusion that the private foundation was not a trust and that no trust relationship existed between the parties. TCO included a condition in the ruling as follows:

    > The Taxpayer has no legal or equitable claim to the private foundation's assets before dissolution.

### Conclusion

23. TCO concluded that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CV 13 or an amount to which s BF 1(b) applied.

## Issue 2 | Take tuarua: Is the distribution dividend income under s CD 1?

24. The Taxpayer requested the Commissioner to rule that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income under s CD 1.

1 See *Law of Trusts (NZ)* (online ed, LexisNexis NZ, accessed 21 February 2023) at [1.6] and *Nevill's Law of Trusts, Wills and Administration*, 13th ed, 2018 (LexisNexis).

25. Section CD 1 provides that a dividend derived by a person is income. "Dividend" is defined in s CD 4. There are also a number of specific transactions that give rise to a dividend. TCO considered that none of these transactions were relevant in the context of the ruling.[2]

### Is the private foundation a "company" for New Zealand tax purposes?

26. For an amount to constitute a "dividend" it must be transferred by a "company". Accordingly, the first question considered by TCO was whether the private foundation could be characterised as a "company" for New Zealand tax purposes.
27. As discussed at [15], answering this question involved two steps.

### Step One – The legal rights and obligations created under the foreign law

28. The rights and obligations of the parties created under the foreign law were summarised above at [19].

### Step Two – Application of New Zealand tax law to the rights and obligations

29. The question at step two was whether the legal rights and obligations of the private foundation as determined under the foreign law would, when applied to the New Zealand context, result in it being viewed as a "company" for New Zealand tax purposes.
30. "Company" is defined in s YA 1. The relevant part of the definition states that a company 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.
31. In TCO's view, the private foundation was a "company" for New Zealand tax purposes on the basis that it had a separate legal existence and was incorporated or created in a foreign jurisdiction. TCO's reasons for this conclusion were:
    - The private foundation was a legal person. It owned assets and could deal with property on its own account.[3]
    - Its legal personality was its "own", separate from the legal personalities of all other parties involved in the private foundation (being the Taxpayer (the founder), the management board, the supervisory board or any person that expected to or had received a distribution from private foundation).
32. TCO noted that its analysis was consistent with:
    - The alternative approach used by the Commissioner in BR PUB 20/01 to 20/5 to determine that a US LLC was a "company" for New Zealand tax purposes.
    - The analysis and conclusion reached by the Australian Tax Office (ATO) in the context of a Stichting created under Netherlands law.[4]

### Is the amount distributed to the Taxpayer by the private foundation a dividend?

33. The first question considered by TCO was whether the amount distributed to the Taxpayer by the private foundation was a dividend. The amount so distributed would be a "dividend" if the following criteria were satisfied:
    - There was a transfer of company value from a company to a person;
    - The cause of the transfer was a shareholding in the company; and
    - None of the exclusions in ss CD 22 to CD 37 applied to the transfer.

2 See ss CD 7, CD 7B, CD 8, CD 9, CD 10, CD 11, CD 12 - CD 14, CD 20.

3 Watts, Campbell and Hare in *Company Law in New Zealand* (2nd ed, LexisNexis NZ Limited, 2016).

4 See an Interpretative Decision of the ATO (ID 2008/62) that considers whether a Dutch Stichting constitutes a body corporate under Australian domestic law.

### Transfer of company value from a company to a person (s CD 5)

34. Section CD 5(1)(a) provides that a transfer of company value from a company to a person occurs when:
    - the company provides money or money's worth to the person; and
    - 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.
35. Case law indicates that the expression "money or money's worth" requires that a benefit be in money or be convertible into money, either directly or indirectly.[5]
36. TCO considered this criteria would be satisfied. On dissolution the private foundation would provide money (proceeds from the sale of the private foundation's investments) and/or money's worth (the private foundation's underlying portfolio investments) to the Taxpayer. As the Taxpayer would not provide any money or money's worth to the private foundation on its dissolution, TCO considered that the market value of what the private foundation provided to the Taxpayer would be more than the market value of what the Taxpayer provided (ie, nil).

### Cause of the transfer is a shareholding in the company (s CD 6)

37. Section CD 6(1) sets out the general test for when a transfer of company value from a company to a person is caused by a shareholding in the company. A transfer of company value is caused by a shareholding in the company if the recipient at *any relevant time*:
    - holds shares in the company; or
    - is associated with a shareholder; and
    - the company makes the transfer because of that shareholding of the relevant shareholder.
38. "Share" is defined in s YA 1. TCO noted that the relevant definition for the purposes of the ruling was contained in para (a). That is, a "share" includes "any interest in the capital of a company". Neither the term "interest" nor "capital" are defined in s YA 1 for these purposes.

#### *Meaning of "any interest in the capital of a company"*

39. TCO considered that "any interest in the capital of a company" for the purposes of the definition of a "share" in s YA 1 may refer to the person's interest in issued share capital, and a right to a share in the surplus assets on a wind up, and may include rights to other distributions.[6] An interest in a company's capital is an interest in the performance of the company that is of an equity nature (rather than a debt or contractual right to receive payments).
40. TCO noted that this was consistent with the position taken by the Commissioner in BR Pub 19/04.

#### *Does the Taxpayer have any interest in the capital of the private foundation?*

41. TCO was satisfied that the amount proposed to be distributed by the private foundation to the Taxpayer was "capital" of the private foundation. The amount proposed to be distributed came from the balance of the private foundation's assets remaining after all debts had been paid off on a wind-up.
42. Although the proposed amount distributed to the Taxpayer came from the private foundation's capital TCO had to consider whether the Taxpayer had "any interest" in the private foundation's capital.
43. Section CD 6(1) provides that a transfer of company value is caused by a shareholding in the company if the recipient "*at any relevant time* holds shares in the company". TCO considered that, in the context of determining whether an amount of capital distributed to a person on the dissolution of a company is a "dividend", the "relevant time" to test whether a person holds a "share" in the company is at the time they receive the amount.

5 *Tennant v Smith* (1892) 3 TC 158 (HL).

6 *Inland Revenue Commissioners v Tring* [1939] 2 All ER 105 (CA).

44. The description of the arrangement in the ruling application outlines the steps involved in dissolving the private foundation, including:
    - The management board preparing a recommendation proposing to dissolve the private foundation for the supervisory board to consider.
    - Once a supervisory board resolution approving the dissolution of the private foundation has been obtained, the management board will determine who the beneficiaries are and how the assets will be divided between the beneficiaries.
    - The management board will then determine how the funds should be distributed.
45. TCO considered at that point the Taxpayer received the distribution they had a right to share in the private foundation's capital on its dissolution and accordingly held a "share" in the private foundation at that time.
46. In addition to the requirement that the recipient of the distribution "hold shares" in the company for a transfer of company value from a company to a person to be caused by a shareholding, the company must make the transfer because of that shareholding of the relevant shareholder (s CD 6 (1)(b)).
47. One indication that a transfer is caused by a shareholding is if the terms of the arrangement that results in the transfer are different from the terms on which the company would enter into a similar arrangement if no shareholding were involved (s CD 6(2)). TCO's view is that, given that it is the management board's decision to make a distribution to the Taxpayer on the private foundation's dissolution that gives rise to the Taxpayer's interest in the capital of the private foundation (and therefore a "share" in the private foundation), it follows the distribution of capital is made because of that shareholding.
48. Accordingly, any amount distributed by the private foundation to the Taxpayer on dissolution will be a "dividend" unless one of the exclusions in ss CD 22 to CD 37 applies.

***Do any of the exclusions in ss CD 22 to CD 37 apply here?***

49. Sections CD 22 to s CD 37 contain a number of exclusions from the definition of "dividend". TCO considered the relevant exclusion was that contained in s CD 26 for amounts paid in relation to a share on the liquidation of a company.
50. "Liquidation" is defined in s YA 1 and includes the termination of the company's existence under any other procedure of New Zealand or foreign law. In TCO's view the dissolution of the private foundation under the foreign law and based on the process set out in the private foundation's articles would constitute a "liquidation" for the purposes of s CD 26.
51. Section CD 26(2) provides that when a shareholder is paid an amount in relation to a share on the liquidation of the company the amount paid is a dividend only to the extent to which it is more than:
    - the available subscribed capital (ASC) per share calculated under the ordering rule; and
    - the available capital distribution amount (ACDA) under s CD 44.
52. ASC for a share in a company is calculated under s CD 43. Broadly, the concept of ASC refers to a company's share capital and include amounts received as consideration for the issue of the company's shares. As mentioned earlier, the private foundation has no share capital and therefore has no ASC. That the private foundation has no ASC is acknowledged by the Taxpayer in the ruling application.
53. A company's ACDA is calculated under s CD 44. Broadly, ACDA is a company's capital gain amounts and reflects the policy that a company can distribute its capital gain amounts to shareholders tax free on liquidation.[7]
54. TCO considered that the exclusion in s CD 26 applied in this case to the extent of the Taxpayer's share of the ACDA calculated under s CD 44.

## Conclusion

55. TCO concluded that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CD 1 to the extent it did not exceed the Taxpayer's share of the ACDA calculated under s CD 44.
56. This conclusion is subject to the following condition:

    > The Management Board resolves to dissolve the private foundation in accordance with the Articles of Incorporation and that amounts distributed by the private foundation to the Taxpayer are distributed after the resolution to dissolve the private foundation has been approved.

7 The Taxpayer did not ask for a ruling on the private foundation's ACDA.

### Issue 3 | Take tuatoru: Is the amount distributed by private foundation on dissolution income under s CA 1(2)?

57. The Taxpayer requested the Commissioner to rule that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income under s CA 1(2). The question considered by TCO was whether the amount distributed to the Taxpayer that did not constitute a "dividend" under s CD 1 (on the basis that it was a distribution of the private foundation's ACDA on dissolution) was income under ordinary concepts.
58. TCO considered the relevant factors for determining the character of receipts in the hands of the recipient included:
    - the scope of the recipient's business (if a business exists),
    - the periodicity, recurrence or regularity of the receipts,[8]
    - the consideration provided for the receipts,[9] and
    - the purpose and reason for which the money is received.[10]
59. TCO concluded that:
    - The distribution was not part of a business because the distribution on dissolution was at the discretion of the management board.
    - The distribution was likely to be a one-off receipt.
    - The Taxpayer did not provide any consideration for the distribution.
    - The reason for the distribution was the management board's decision to distribute its net assets to such person as they determine, of which the Taxpayer was one. The amounts distributed to the Taxpayer were funded by the private foundation's ACDA and were capital in nature.
60. TCO considered that the above features indicated that the amount distributed to the Taxpayer and which was not a dividend under s CD 1 (on the basis that it did not exceed the private foundation's ACDA) would be capital in nature and not income under s CA 1(2) (income under ordinary concepts) of the Taxpayer.

#### Conclusion

61. TCO concluded that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CA 1(2).

8 *Reid v CIR* [1985] 7 NZTC 5,176 (CA).

9 *MIM Holdings Ltd v FCT* 97 ATC 4,420 (FFCA), *The Federal Coke Company Ltd v FCT* 77 ATC 4,255 (FCA).

10 *McLaurin v FCT* (1961) 104 CLR 381, *Reid v CIR*, *The Federal Coke Company Ltd v FCT*, *Riches v Westminster Bank Ltd* [1947] AC 390.