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CHOICE BETWEEN AVAILABLE FIF CALCULATION METHODS

(1) Five calculation methods (from 1 July 2011)	**FIF calculation methods** If the tests in sections CQ 5 (when FIF income arises) or DN 6 (when FIF losses arise) are met, the amount of a person's FIF income or loss is calculated under: 1. The attributable FIF income (AFI) method (available from the first income year beginning on or after 1 July 2011 onwards). 2. The comparative value method. 3. The deemed rate of return method. 4. The fair dividend rate method. 5. The cost method. 6. The accounting profits (AP) method (unavailable from the first income year beginning on or after 1 July 2011 onwards). 7. The branch equivalent (BE) method (unavailable from the first income year beginning on or after 1 July 2011 onwards). [Section **EX 44(1)** as amended by **S. 31** of the *Taxation (International Investment and Remedial Matters) Act 2012* – repeal of the "accounting profits method" and replacement of the "branch equivalent (BE) method" with the AFI method, from the first income year beginning on or after 1 July 2011]
(2) Method for choosing	**How a calculation method is chosen** The person must choose which calculation method applies by completing their return of income accordingly, but the choice is limited by sections EX 46, EX 47, EX 48 and EX 62. [Section **EX 44(2)]**

(3) Same method for same FIF	**<u>Calculation method for 2 or more attributing interests in the same FIF</u>** The same calculation method must be used for 2 or more attributing interests if: (a) They are interests in <u>the same FIF</u>; and (b) The calculations are for the same period; and (c) The interests are <u>not of different classes</u>; and (d) Section EX 46 does not prevent the same method being used for the interests. **<u>Same FIF:</u>** What is "the same FIF" is not defined. A FIF is defined in section YA 1 as meaning "a foreign investment fund as defined in section EX 28". Section EX 28 states that a foreign investment fund, or FIF, is any of 4 types of entities: a foreign company, a foreign superannuation scheme, an insurer under a life insurance policy not offered or entered into in New Zealand, and an entity described in schedule 25, part A. The better view is that "the same FIF" means a particular entity that is a FIF, and not a type of entity. **<u>Different Classes:</u>** What constitutes "different classes" is not defined. Each case will need to be determined based on its own merits. [Section **EX 46(1)**]

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<td>(4) Attributable FIF Income (AFI) method</td>
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<u>Limitations on the use of the Attributable FIF Income (AFI) method</u>
This method is only available for income years starting on or after 1 July 2011.
[Clause 26(2) of the International Investment bill]
A person may use the AFI method to calculate FIF income or loss for an attributing interest in a FIF for an accounting period only if requirements A & B below are met:
A. The person can provide to the Commissioner, if requested, sufficient information to enable the Commissioner to check the <u>calculations required by section EX 50 as amended by section 35 of the International Investment Tax Act</u>; and
B. <u>One of the following 2 requirements is met</u>:
1. At all times in the accounting period:
(a) The FIF is a company; and
(b) The item “income interest” given by section EX 50(4) for the person and the FIF is at least 10%; and
(c) The person is not a Portfolio Investment Entity (PIE).
2. The FIF is a CFC and:
(a) The person cannot determine the market value of the attributing interest at the beginning of the accounting period except by independent valuation; and
(b) Neither the person nor a person who has a direct income interest of at least 10% in the FIF is:
(i) A listed company.
(ii) A group investment fund.
(iii) A PIE.
(iv) A superannuation scheme.
(v) A unit trust.
(vi) A trustee of a trust with a beneficiary described in 1 or more of subparagraphs (i) to (iv) above.
[Section EX 46(3) as replaced by s. 32(2) of the Taxation (International Investment and Remedial Matters) Act 2012 with application to income years beginning on or after 1 July 2011]
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<tr><td>(5) Deemed Rate of Return (DRR) method</td><td><u>Limitations on the use of the Deemed Rate of Return (DRR) method</u>

From income years beginning on or after 1 July 2011, a person may use the DRR method to calculate FIF income or loss from an attributing interest in a FIF only if required to use the DRR method because:
1. The attributing interest is a <u>non-ordinary share</u> in a foreign company as described in section EX 46(10) (refer to (9) below); and
2. The use of the comparative value (CV) method is not practical because the person cannot determine the market value of the attributing interest at the end of the income year.

[Section EX 46(4) as repealed by s. 32(3) of the Taxation (International Investment and Remedial Matters) Act 2012, section EX 46(5) as replaced by s. 32(4) of the Taxation (International Investment and Remedial Matters) Act 2012 and section EX 47]</td></tr>
<tr><td>(6) Comparative Value (CV) method</td><td><u>Limitations on the use of the Comparative Value (CV) method for a FIF that is a share in a foreign company</u>

A person may use the CV method to calculate FIF income or loss from an attributing interest in <u>a FIF that is a share in a foreign company</u> for an income year only if:
1. The person is a natural person.
2. The person is a trustee of a trust that:
(a) Has no <u>gifting settlor</u> who is not a natural person or deceased person, meaning that no person, who is not the trustee of a trust or a natural person or deceased person has made a transfer of value, by disposing of property, to the trustee of:
(i) The relevant trust; or
(ii) A trust with a trustee who settles property on the relevant trust, directly or through the trustees of other trusts; and
(b) At all times in the income year, is a complying trust for a distribution made at the time; and
(c) Is, at all times in the income year, mainly for the benefit of
(i) A natural person for whom the gifting settlors of the trust have natural love and affection (or had natural love and affection when alive); or
(ii) An organisation or trust with income that is exempt income under sections CW 41 or 42 (which exempt certain income of charities); and
(d) Is not a superannuation scheme.
3. The share is a <u>non-ordinary share</u> (refer to (9) on page 6 below).

[Sections EX 46(6) & (12) and s. 32(5) of the Taxation (International Investment and Remedial Matters) Act 2012 which repeals section EX 46(6)(c) that allowed the CV method to be used by persons with direct income interests ≥ 10%]</td></tr>
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(7) Fair Dividend Rate (FDR) method	**Limitations on the use of the Fair Dividend Rate (FDR) method for a FIF that is a share in a foreign company** A person must not use the FDR method to calculate FIF income or loss from an attributing interest in a FIF that is a share in a foreign company for an income year if: (a) The share is a non-ordinary share described in section EX 46(10) (refer to **(9)** below); or (b) The person chooses to use the CV method for another attributing interest that is a share in a foreign company and for which the person would be allowed, in the absence of this rule, to use the FDR method. [Section **EX 46(8)** as amended by **s. 32(7)** of the *Taxation (International Investment and Remedial Matters) Act 2012* & **repeal of section EX 46(7)** by **s. 32(6)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, from income years beginning on or after 1 July 2011]
(8) Cost method	**Limitations on the use of the cost method for a FIF that is a share in a foreign company** A person may use the cost method to calculate FIF income or loss from an attributing interest in a FIF that is a share in a foreign company only if: • Use of the FDR method is allowed but not practical because the person cannot determine the MV of the attributing interest at the start of the income year except by an independent valuation. [Section **EX 46(9)** as amended by **s. 32(8)** of the *Taxation (International Investment and Remedial Matters) Act 2012* from income years beginning on or after 1 July 2011]

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<td>(9) Non-ordinary shares</td>
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<u>Certain non-ordinary shares</u>
For the purpose of the <u>CV Inclusion</u> in section EX 46(6)(d) and the <u>FDR exclusion</u> in section EX 46(8)(a), a non-ordinary share in a foreign company is:
(a) A fixed-rate share (for income years beginning on or after 1 July 2011 – before that: fixed-rate foreign equity). Refer to the separate PDF attachment comparing a Fixed-Rate Share, Fixed-Rate Foreign Equity and a Non-Participating Redeemable Share.
(b) A non-participating redeemable share. (See the attachment referred to above).
(c) An interest in a non-resident holding directly or indirectly assets of which 80% or more by value at a time in the income year:
(i) Consist of fixed-rate foreign equities, or financial arrangements providing funds to a person; and
(ii) Are denominated in NZ$, or under NZIAS 39, are hedged items having a value in NZ$ governed by a hedging instrument that is highly effective.
(d) An interest in a non-resident if:
(i) The non-resident holds directly or indirectly assets of which 80% or more by value at a time in the income year consist of fixed-rate foreign equities, or financial arrangements providing funds to a person, ignoring financial arrangements between the non-resident and other members of a group of companies that it is a member of; and
(ii) The non-resident is not listed on a recognised exchange or is listed on a regognised exchange but is a foreign PIE equivalent, ignoring section HL 10(4) (which is now repealed but referred to exempting the maximum shareholding requirements in shares in unlisted companies where the investee company was a PIE or a foreign investment vehicle); and
(iii) The interest is, under NZIAS 39, a hedged item having a value in NZ$ governed by a hedging instrument that is highly effective.
(e) A share that involves an obligation:
(i) Of another person to provide to the investor, directly or indirectly through an arrangement, an amount that is more than the issue price of the share; and
(ii) That is non-contingent or subject to a contingency that is sufficiently remote to be immaterial.
(f) A share of a kind that the Commissioner determines under section 91AAO of the Tax Administration Act 1994 to be an interest for which the fair dividend rate method is not available
(g) The Commissioner can override paragraphs (a) to (d) and determine under section 91AAO of the Tax Administration Act 1994 that a share is an interest for which the fair dividend rate is available.
[Sections EX 46(10) & (11) as amended by section 39 of the Tax Administration Act 2011 effective from 1 July 2009]
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<td>(10) Limitations on Accounting Profits (AP) method (method repealed from 1 July 2011)</td>
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<u>Limitations on Accounting Profits (AP) Method</u>
<u>This method is not available for income years starting on or after 1 July 2011.</u>
[Clause 32(1) of the International Investment Tax Act]
A person may use the accounting profits method for an accounting period to calculate FIF income or loss from an attributing interest in a FIF only if all the following requirements are met:
1. The FIF must be a company.
2. At all times during the accounting period when the FIF exists, interests in the FIF similar to the person's attributing interests were:
(a) Quoted on the official list of a recognised exchange; or
(b) Offered widely by or for the FIF to the public in 1 or more countries.
3. The net after-tax accounting profits or losses of the FIF for the accounting period are calculated under generally accepted accounting practice (GAAP), or an equivalent standard for consistent and undistorted reporting of net profits, of the country in which the FIF is resident.
4. The net after-tax accounting profits or losses are detailed in financial statements:
(a) Sent or made available to shareholders in the FIF; and
(b) Readily available to interested members of the public; and
(c) Audited by a chartered accountant, or accountant of equivalent professional standard in the country in which the FIF is resident; and
(d) For which such an accountant has given a standard audit opinion, without qualifications, to the effect that the financial statements represent the income and financial position of the FIF to the degree of validity normally required in the country in which the FIF is resident.
5. Where the FIF has 1 or more subsidiaries, the net after-tax accounting profits or losses are calculated on a consolidated basis.
6. The net after-tax accounting profits or losses include any extraordinary items.
7. The person has no reason to believe that the net after-tax accounting profits or losses do not fairly represent the net after-tax accounting profits or losses of the FIF for the accounting period.
8. The FIF is not an entity described in Schedule 25, Part C (Foreign entities for which accounting profits method may not be used).
9. The Commissioner has not concluded that the net after-tax accounting profits or losses do not fairly represent the net after-tax profits or losses of the FIF for the accounting period.
[Section EX 46(2)]
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(11) Branch equivalent (BE) method (repealed from 1 July 2011)	**<u>Limitations on Branch Equivalent (BE) method</u>** **<u>This method is not available for income years starting on or after 1 July 2011.</u>** [Clause **32(2)** of the International Investment Tax Act] A person may use the branch equivalent (BE) method to calculate FIF income or loss from an attributing interest in a FIF for an accounting period only if: 1. The FIF is a company; and 2. The person can provide to the Commissioner, if requested, sufficient information to enable the Commissioner to check the calculations required by section EX 50 before the amendments to that section contained in clause 29 of the International Investment bill took effect (i.e. section EX 50 before 1 July 2011). [Section **EX 46(3)**]

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<td>(12) Default calculation methods</td>
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<u>Default calculation methods</u>
The default calculation methods apply when:
(a) A person does not choose a calculation method to calculate FIF income or loss from an attributing interest for a period; and
(b) Sections EX 46, EX 47 and EX 62 do not have the effect of requiring a particular calculation method to be used:
<u>Section EX 46</u> requires a particular calculation method to be used in the following circumstances:
(a) If a person has 2 or more attributing interests in the same FIF for the same period, the same calculation method must be used for both, unless:
(i) The interests are of different classes; and
(ii) Section EX 46 prevents the same method from being used.
(b) Section EX 46 sets out the circumstances in which:
(i) The AFI, DRR, CV and Cost methods may be used (refer to (4), (5), (6) & (8) above); and
(ii) The FDR method may not be used (refer to (7) above).
<u>Section EX 47</u> requires the CV method to be used for attributing interest that is a non-ordinary share, and if it is not practical to use CV method, then the DRR method must be used (refer to (5) above).
<u>Section EX 62</u> sets down the rules on changing calculation methods (refer to (13) to (17) below).
<u>The default calculation methods are</u>:
(a) The FDR method, if it is practical to use it; and
(b) The Cost method, if it is not practical to use the FDR method.
[Section EX 48 as amended by s. 33 of the Taxation (International Investment and Remedial Matters) Act 2012, applying from income years beginning on or after 1 July 2011]
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<td>(13) Changing between methods: general rule</td>
<td>
<u>Changing methods general rule: No change unless allowed</u>
Once a person uses a particular calculation method to calculate FIF income or loss for an attributing interest in a FIF for a particular period, they must use the same method for interests in the FIF for the next period unless they are allowed to change by sections EX 62(2) to (9).
[Section EX 62(1)]
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<td>(14) Basis for changing from a method</td>
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<u>Basis for changing from a particular method to another method</u>

A person may change if it is not practical to continue with the same method because:

1. In the case of the <u>Accounting Profits (AP</u>) method:
(a) The method is no longer available for income years commencing on or after 1 July 2011; or
(b) For income years beginning before 1 July 2011:
(i) The requirements to use the AP method in section EX 46(2) are not met; or
(ii) It is impossible to obtain enough information to continue using the AP method.
2. In the case of the <u>Attributed FIF Income (AFI)</u> method:
(a) The requirements to use the method in section Ex46(3) are not met; or
(b) It is impossible to obtain enough information to continue using the AFI method.

3. In the case of the <u>CV</u> method:
(a) The requirements to use the method in section EX 46(6) are not met; or
(b) It is impossible to find out the year-end MV of the interest.

4. In the case of the <u>DRR</u> method:
• The person is required by section EX 47 to use the CV method, because it is practical to do so.

5. In the case of the <u>FDR</u> method:
• It is impossible to find out the MV of the interest at the beginning of the year except by independent valuation.

6. In the case of the <u>Cost</u> method:
• The requirement in section EX 46(9) to use the Cost method for a FIF that is a share in a foreign company is not met because use of the FDR method is allowed and it is practical to use the FDR method.

[Section EX 62(2) as amended by s. 41(1) to 41(6) of the Taxation (International Investment and Remedial Matters) Act 2012, effective from income years beginning on or after 1 July 2011]
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<td>(15) Other reasons for change</td>
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<u>Change by notice to the Commissioner</u>
A person may change methods by notice to the Commissioner if both of the following requirements are met:
1. The first requirement is that:
(a) The person requesting the change is a natural person whose total attributing interests in FIFs have a market value ≤ $250,000 at the end of the year or period <u>before</u> the year or period in which the change is to take effect; or
(b) The change is to, or from, the AFI method, and:
(i) The person is changing from the use of the BE method (which is being repealed); or
(ii) It is the first time the person has chosen to change to, or from, the AFI method for an attributing interest in the FIF (not counting an earlier change from the BE method); or
(iii) It is not the first time the person has chosen to change to, or from, the AFI method for an attributing interest in the FIF, but:
a. There has been a change in circumstances, such as a significant change in shareholding, that significantly changes the person's ability to obtain enough information to use the AFI method; and
b. Altering their income tax liability is not the principal purpose or effect of the change.
2. The second requirement is that the notice must comply with the following contents and timing requirements:
(a) The notice gives the reason(s) for the change; and
(b) The notice complies with the Commissioner's notice requirements; and
(c) The notice is given before the end of the first income year or accounting period for which the change is to take effect, unless the Commissioner agrees to a retrospective notice; and
(d) In the case of a natural person relying on the $250,000 threshold test, be given before the end of the year or period <u>before</u> the year or period in which the change is to take effect.
[Sections EX 62(3) to (7) as amended by s. 41(7) to (9) of the Taxation (International Investment and Remedial Matters) Act 2012, effective from income years beginning on or after 1 July 2011]
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<tr><td>(16) Repeated changes between FDR and CV methods</td><td><u>Changing more than once from FDR to CV and from CV to FDR</u>

A person may change more than once from the FDR method to the CV method and from CV to FDR if:

1. The person is a natural person; or

2. The person is a trustee of a trust that:
(a) Has no <u>gifting settlor</u> who is not a natural person or deceased person, meaning that no person, who is not the trustee of a trust or a natural person or deceased person has made a transfer of value, by disposing of property, to the trustee of:
(i) The relevant trust; or
(ii) A trust with a trustee who settles property on the relevant trust, directly or through the trustees of other trusts; and
(b) At all times in the income year, is a complying trust for a distribution made at the time; and
(c) Is, at all times in the income year, mainly for the benefit of
(i) A natural person for whom the gifting settlors of the trust have natural love and affection (or had natural love and affection when alive); or
(ii) An organisation or trust with income that is exempt income under sections CW 41 or 42 (which exempt certain income of charities); and
(d) Is not a superannuation scheme.

[Section EX 62(8)]</td></tr>
<tr><td>(17) Changing to FDR when the rules are changed</td><td><u>Changing to FDR when the rules are changed</u>

There are concessions that apply when the rules change on 1 July 2011, and when the rules changed previously on 1 July 2009:

1. In a person's return for the 1st income year beginning on or after 1 July 2011, a person may change from any of the AP, BE, or DRR methods to the FDR method.

2. In a person's return for the 2009-10 income year, a person could change from the AP or BE methods to the FDR method (and this concession also applied to the 2008-09 income tax return if it had not been filed before 6 October 2009, the date on which the amending legislation received the Royal assent).

[Section EX 62(10) as inserted by s. 41(10) of the Taxation (International Investment and Remedial Matters) Act 2012 and section EX 62(9)]</td></tr>
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(18) Consequences of changing methods: Cost-based methods to/from look-through methods	**<u>Consequences of changing - Cost-based to/from look-through methods: Disposal and re-acquisition at market value</u>** If a person holding an attributing interest in a FIF changes the FIF calculation method: (a) From 1 of the 4 cost-based calculation methods (CV, DRR, FDR or Cost) to the AFI method; or (b) From a look-through calculation method (AP, BE or AFI) to 1 of the 4 cost-based methods: 1) The person is treated as having disposed of the interest to an unrelated person immediately before the beginning of the 1st <u>accounting period</u> to which the new method applies; and 2) The person is treated as having re-acquired it immediately after the beginning of the <u>period</u>; and 3) The person is treated as having received for the disposal and having paid for the re-acquisition an amount equal to the interest's market value at the time. [Section **EX 63(1)** as amended by **s. 42** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective for income years beginning on or after 1 July 2011 & section EX **63(2)**]
(19) Consequences of changing methods: CV/FDR to Cost/DRR	**<u>Consequences of changing – CV/FDR to Cost/DRR: Disposal and re-acquisition at market value</u>** If a person holding an attributing interest in a FIF changes the FIF calculation method from either the CV method or the FDR method to either the Cost method or the DRR method: 1) The person is treated as having disposed of the interest to an unrelated person immediately before the beginning of the 1st <u>income year</u> to which the new method applies; and 2) The person is treated as having re-acquired it immediately after the beginning of the <u>income year</u>; and 3) The person is treated as having received for the disposal and having paid for the re-acquisition an amount equal to the interest's market value at the time. [Section **EX 63(3)**]

(20) Consequences of changing methods: Cost/DRR to CV/FDR	**<u>Consequences of changing – Cost/DRR to CV/FDR: Disposal and re-acquisition at market value</u>** If a person holding an attributing interest in a FIF changes the FIF calculation method from either the Cost method or the DRR method to either the CV method or the FDR method: 1) The person is treated as having disposed of the interest to an unrelated person immediately before the beginning of the 1st <u>income year</u> to which the new method applies; and 2) The person is treated as having re-acquired it immediately after the beginning of the <u>income year</u>; and 3) The person is treated as having received for the disposal and having paid for the re-acquisition an amount equal to: (i) For a person <u>changing from the Cost method</u>: The amount that would be the interest's opening value under section EX 56 if the person had continued to use the Cost method for the 1st income year to which the new method applies; or (ii) For a person <u>changing from the DRR method</u>: The interest's closing book value under section EX 55(7) for the preceding income year. [Section **EX 63(4)**]
(21) Consequences of changing methods: Changes between CV and FDR	**<u>Consequences of changing – Changes between CV and FDR: Disposal and re-acquisition at market value</u>** If a person holding an attributing interest in a FIF changes the FIF calculation method from the CV method to the FDR method or from the FDR method to the CV method: 1) The person is treated as having disposed of the interest to an unrelated person immediately before the beginning of the 1st <u>income year</u> to which the new method applies; and 2) The person is treated as having re-acquired it <u>at the beginning</u> of the 1st <u>income year</u> to which the new method applies; and 3) The person is treated as having received for the disposal and having paid for the re-acquisition an amount equal to the interest's market value at the time. [Section **EX 63(5)**]