DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

SUMMARY OF THE CHOICES BETWEEN FIF METHODS FROM 1 JULY 2011 ONWARDS

1. Page 2 contains a Table summarising the FIF method choices and limitations applying to income years commencing on or after 1 July 2011.

2. The Table should be read in conjunction with the Notes that follow, which are referenced back to the Table.

3. Following the Notes is a section on Changing Between Calculation Methods on pages 9 to 11.

4. A section on Consequences of Changes in Method is set out on pages 12 to 13.

SUMMARY OF FIF METHOD CHOICES FROM 1 JULY 2011

Refer to the **Table** below and the **Notes** that follow it. Further below are the rules on changing methods

	Rules regarding the choice of the FIF calculation method (for income years beginning on or after 1 July 2011)	**AFI**	**DRR**	**CV**	**FDR**	**COST**
I	If the person is a natural person and the attributing interest is an ordinary share in a foreign company: Default method: If no method is chosen, the natural person is treated as having chosen: (a) FDR, if it is practical to use it; or (b) Cost if it is not practical to use FDR. [See **Note (6)**]	✔ But only if **Note (1)** is met	✖ See **Note (2)**	✔ See **Note (3)**	✔ But not if CV also used – see **Note (4)**	✔ Only if FDR allowed but can't be used - see **Note (5)**
II	If the person is a trustee and the attributing interest is an ordinary share in a foreign company: Default method: If no method is chosen, the trustee is treated as having chosen: (a) FDR, if it is practical to use it; or (b) Cost if it is not practical to use FDR. [See **Note (12)**]	✔ But only if **Note (7)** is met	✖ See **Note (8)**	✔ Only if **Note (9)** is met	✔ But not if CV also used – see **Note (10)**	✔ Only if FDR allowed but can't be used - see **Note (11)**
III	If the person is a company and the attributing interest is an ordinary share in a foreign company: Default method: If no method is chosen, the natural person is treated as having chosen: (a) FDR, if it is practical to use it; or (b) Cost if it is not practical to use FDR. [See **Note (18)**]	✔ But only if **Note (13)** is met	✖ See **Note (14)**	✖ See **Note (15)**	✔ See **Note (16)**	✔ Only if FDR can't be used - see **Note (17)**
IV	Any person and the attributing interest is a non-ordinary share in a foreign company: Default method: CV must be used, and if not practical, DRR. [See **Note 19**]	✖ See **Note (19)**	✔ Only if CV can't be used see **Note (19)**	✔ See **Note (19)**	✖ See **Note (19)**	✖ See **Note (19)**
V	Any person if the attributing interest is a right to benefit from a foreign superannuation scheme: Default method: FDR or if not practical, Cost.	✖ See **Note (20)**	✖ See **Note (21)**	✔ See **Note (22)**	✔ See **Note (22)**	✔ See **Note (22)**
VI	Any person if the attributing interest is a right to benefit from a life insurance policy for which a FIF is the insurer: Default method: FDR or if not practical, Cost.	✖ See **Note (20)**	✖ See **Note (21)**	✔ See **Note (22)**	✔ See **Note (22)**	✔ See **Note (22)**

NOTES:

I Natural person with an attributing interest that is an ordinary share in a foreign company

(1) The natural person must be able to provide the Commissioner, if requested, with sufficient information to enable the Commissioner to check the calculations required by section EX 50 and either:

(a) Have an income interest in the FIF ≥ 10%; or

(b) The FIF must be a CFC and:

(i) The person cannot determine the market value of the attributing interest at the beginning of the accounting period except by independent valuation; and

(ii) Any person who has a direct income interest ≥ 10% in the FIF is not:

1. A listed company.
2. A group investment fund.
3. A PIE.
4. A superannuation scheme.
5. A unit trust.
6. A trustee of a trust with a beneficiary described in 1 or more of subparagraphs 1 to 4 above.

[Section **EX 46(3)** as inserted by section **32(2)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(2) The DRR method can only be used for an attributing interest that is a non-ordinary share.

Note: The ability of a natural person with an interest ≥ 10% in a foreign company (and it is not practical to use the CV or AP methods or total FIF interests are valued at ≤ $250,000) to use the DRR method has been repealed, with effect from income years beginning on or after 1 July 2011.

[Section **EX 46(5)** as replaced by section **32(4)** & section EX 46(4) repealed by section **32(3)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011 & section **EX 47**]

(3) A natural person may use the CV method for a FIF that is a share in a foreign company.

[Section **EX 46(6)(a)**]

(4) A natural person may use the FDR method for a FIF that is an ordinary share in a foreign company, provided that:

- The person has not chosen to use the CV method for another FIF that is a share in a foreign company for which the FDR method could have been used.

Note: The restriction of the use of the FDR method to natural persons with income interests < 10% has been removed, effective from income years beginning on or after 1 July 2011.

[Section **EX 46(8)** and the repeal of section **EX 46(7)** by section **32(6)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

NOTES (continued)

(5) A natural person may use the cost method for a FIF that is a share in a foreign company only if:

- FDR is allowed, but not practical because the person cannot determine the market value ("MV") of the attributing interest at the start of the year except by independent valuation.

Note: The restriction of the use of the Cost method to natural persons with income interests < 10% has been removed, effective from income years beginning on or after 1 July 2011.

[Section **EX 46(9)** as amended by section **32(8)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(6) If a natural person does not choose a method for a FIF interest that is an ordinary share in a foreign company, the person is treated as having chosen to use, for the period:

(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.

Note: The previous rule that the FDR method (and failing that, the Cost method) was the default method only for interests < 10% is being repealed.

The rule that for FIF interests ≥ 10% the default methods were AP, CV & DRR, in that order, is also being repealed.

[Section **EX 48** as amended by section **33** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective from income years beginning on or after 1 July 2011]

II Trustee with an attributing interest that is an ordinary share in a foreign company

(7) The trust must not be a PIE, and the trustee must be able to provide the Commissioner, if requested, with sufficient information to enable the Commissioner to check the calculations required by section EX 50 and either:

(a) Have an income interest in the FIF ≥ 10%; or

(b) The FIF must be a CFC and:

(i) The trustee cannot determine the market value of the attributing interest at the beginning of the accounting period except by independent valuation; and

(ii) Neither the trust nor any person who has a direct income interest ≥ 10% in the FIF is:

1. A listed company.
2. A group investment fund.
3. A PIE.
4. A superannuation scheme.
5. A unit trust.
6. A trustee of a trust with a beneficiary described in 1 or more of subparagraphs 1 to 4 above.

[Section **EX 46(3)** as inserted by section **32(2)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

NOTES (continued)

(8) The DRR method can only be used for an attributing interest that is a non-ordinary share.

Note: The ability of a trustee with an interest ≥ 10% in a foreign company (and it is not practical to use the CV or AP methods) to use the DRR method has been repealed, with effect from income years beginning on or after 1 July 2011.

[Section **EX 46(5)** as replaced by section **32(4)** & section EX 46(4) repealed by section **32(3)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011 & section **EX 47**]

(9) A trustee may use the CV method for a FIF that is a share in a foreign company only if the trust:

(a) Has no gifting settlor 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 46(6)(b)**]

(10) A trustee may use the FDR method for a FIF that is an ordinary share in a foreign company, provided that:

- The trustee has not chosen to use the CV method for another FIF that is a share in a foreign company for which the FDR method could have been used.

Note: The restriction of the use of the FDR method to trustees with income interests < 10% or trustees of a PIE has been removed, effective from income years beginning on or after 1 July 2011.

[Section **EX 46(8)** and the repeal of section **EX 46(7)** by section **32(6)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(11) A trustee may use the cost method for a FIF that is a share in a foreign company only if:

- FDR is allowed, but not practical because the trustee cannot determine the market value ("MV") of the attributing interest at the start of the year except by independent valuation.

Note: The restriction of the use of the Cost method to trustees with income interests < 10% has been removed, effective from income years beginning on or after 1 July 2011.

[Section **EX 46(9)** as amended by section **32(8)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

NOTES (continued)

(12) If a trustee does not choose a method for a FIF interest that is an ordinary share in a foreign company, the trustee is treated as having chosen to use, for the period:

(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.

Note: The previous rule that the FDR method (and failing that, the Cost method) was the default method only for interests < 10% is being repealed.

The rule that for FIF interests ≥ 10% the default methods were AP, CV & DRR, in that order, is also being repealed.

[Section **EX 48** as amended by section **33** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective from income years beginning on or after 1 July 2011]

III Company with an attributing interest that is an ordinary share in a foreign company

(13) The company must be able to provide the Commissioner, if requested, with sufficient information to enable the Commissioner to check the calculations required by section EX 50 and either:

(a) Have an income interest in the FIF ≥ 10%; or

(b) The FIF must be a CFC and:

- (i) The company cannot determine the market value of the attributing interest at the beginning of the accounting period except by independent valuation; and
- (ii) Neither the company, nor any person who has a direct income interest ≥ 10% in the FIF is:
  1. A listed company.
  2. A group investment fund.
  3. A PIE.
  4. A superannuation scheme.
  5. A unit trust.
  6. A trustee of a trust with a beneficiary described in 1 or more of subparagraphs 1 to 4 above.

[Section **EX 46(3)** as inserted by section **32(2)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(14) The DRR method can only be used for an attributing interest that is a non-ordinary share.

Note: The ability of a company with an interest ≥ 10% in a foreign company (and it is not practical to use the CV or AP methods) to use the DRR method has been repealed, with effect from income years beginning on or after 1 July 2011.

[Section **EX 46(5)** as replaced by section **32(4)** & section **EX 46(4)** repealed by section **32(3)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011 & section **EX 47**]

NOTES (continued)

(15) A company cannot use the CV method for an attributing interest that is an ordinary share in a foreign company.

[Section **EX 46(6)(c)** repealed by section **32(5)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(16) A company may use the FDR method for a FIF that is an <u>ordinary share</u> in a foreign company.

<u>Note</u>: The restriction of the use of the FDR method to companies with income interests < 10% or PIEs or Life Insurance companies has been removed, effective from income years beginning on or after 1 July 2011.

[Section **EX 46(8)** and the repeal of section **EX 46(7)** by section **32(6)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(17) A company may use the cost method for a FIF that is a share in a foreign company only if:

- FDR is not practical because the company cannot determine the market value ("MV") of the attributing interest at the start of the year except by independent valuation.

<u>Note</u>: The restriction of the use of the Cost method to companies with income interests < 10% has been removed, effective from income years beginning on or after 1 July 2011.

[Section **EX 46(9)** as amended by section **32(8)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, applying from income years beginning on or after 1 July 2011]

(18) If a company does not choose a method for a FIF interest that is an ordinary share in a foreign company, the company is treated as having chosen to use, for the period:

(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.

<u>Note</u>: The previous rule that the FDR method (and failing that, the Cost method) was the default method only for interests < 10% is being repealed.

The rule that for FIF interests ≥ 10% the default methods were AP, CV & DRR, in that order, is also being repealed.

[Section **EX 48** as amended by section **33** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective from income years beginning on or after 1 July 2011]

NOTES (continued)

IV <u>Any person with an attributing interest that is a non-ordinary share in a foreign company</u>

(19) A person (whether a natural person, a trustee or a company) must calculate FIF income or loss from an attributing interest that is a non-ordinary share described in section EX 46(10) using:

(a) The CV method; or

(b) The DRR method, if the use of the CV method is not practical because the person cannot determine the market value ("MV") of the attributing interest at the end of the income year.

[Section **EX 47**]

V & VI <u>Any person with an interest in a foreign superannuation scheme or life insurance policy</u>

(20) The AFI method can only be used for a FIF that is a company or a CFC. The AFI method cannot be used for a FIF interest in a foreign superannuation scheme or a life insurance policy.

[Section **EX 46(3)** as replaced by section **32(2)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective from income years beginning on or after 1 July 2011]

(21) The DRR method cannot be used. It can only be used if it is required to be used by section EX 47 for an attributing interest that is a non-ordinary share described in section EX 46(10), if the use of the CV method is not practical because the person cannot determine the market value ("MV") of the attributing interest at the end of the income year.

<u>Note</u>: The ability of natural persons with FIF interests valued at ≤ $250,000 to use the DRR method has been repealed, with effect from income years beginning on or after 1 July 2011.

[Sections **EX 46(5)** as amended by section **32(4)** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective from income years beginning on or after 1 July 2011 & section **EX 47**]

(22) There are no restrictions on the use of the CV, FDR or Cost methods for a right to benefit from a FIF that is a foreign superannuation scheme, or a right to benefit from a life insurance policy for which a FIF is the insurer.

If no method is chosen, the default method is FDR, and if it is not practical to use FDR, the Cost method.

<u>Note</u>: The requirement to use the CV and DRR methods, in that order, as the default methods, is also being repealed.

[Amendment of section **EX 48** by section **33** of the *Taxation (International Investment and Remedial Matters) Act 2012*, effective from income years beginning on or after 1 July 2011]

CHANGING BETWEEN CALCULATION METHODS

General Rule: No changes unless allowed

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)**]

Basis for changing from a particular method to another method

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

1. In the case of the Accounting Profits (AP) 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 Attributed FIF Income (AFI) method:
   (a) The requirements to use the method in section EX 46(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 CV 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 DRR 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 FDR 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 Cost 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 section **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]

CHANGING BETWEEN CALCULATION METHODS (continued)

Change by notice to the Commissioner

7. A person may change methods by notice to the Commissioner if both of the following requirements are met:

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 before 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.

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 before the year or period in which the change is to take effect.

[Sections **EX 62(3) to (7)** as amended by section **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]

CHANGING BETWEEN CALCULATION METHODS (continued)

Changing more than once from FDR to CV and from CV to FDR

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

   (a) The person is a natural person; or

   (b) The person is a trustee of a trust that:
      1) Has no gifting settlor 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
      2) At all times in the income year, is a complying trust for a distribution made at the time; and
      3) 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
      4) Is not a superannuation scheme.

[Section **EX 62(8)**]

Changing to FDR when the rules are changed

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

   (a) 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.

   (b) 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 section **41(10)** of the *Taxation (International Investment and Remedial Matters) Act 2012*and section **EX 62(9)**]

CONSEQUENCES OF CHANGES IN METHOD

Consequences of changing - Cost-based to/from look-through methods: Disposal and re-acquisition at market value

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 accounting period to which the new method applies; and

2) The person is treated as having re-acquired it *at the start of* the period; 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 section **42** of the *Taxation (International Investment and Remedial Matters) Act 2012* & section EX **63(2)** as proposed to be amended (*in italics*) by **cl 34C(1)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* as reported from the Finance and expenditure Committee on 6 June 2013, both effective for income years beginning on or after 1 July 2011.]

Consequences of changing – CV/FDR to Cost/DRR: Disposal and re-acquisition at market value

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 income year to which the new method applies; and

2) The person is treated as having re-acquired it *at the start of* the income year; 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)** as proposed to be amended (*in italics*) by **cl 34C(2)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* as reported from the Finance and expenditure Committee on 6 June 2013, effective for income years beginning on or after 1 July 2011.]

CONSEQUENCES OF CHANGES IN METHOD (continued)

Consequences of changing – Cost/DRR to CV/FDR: Disposal and re-acquisition at market value

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 income year to which the new method applies; and

2) The person is treated as having re-acquired it *at the start of* the income year; 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 changing from the Cost method: 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 changing from the DRR method: The interest's closing book value under section EX 55(7) for the preceding income year.

[Section **EX 63(4)** as proposed to be amended (*in italics*) by **cl 34C(2)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* as reported from the Finance and expenditure Committee on 6 June 2013, effective for income years beginning on or after 1 July 2011.]

Consequences of changing – Changes between CV and FDR: Disposal and re-acquisition at market value

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 income year to which the new method applies; and

2) The person is treated as having re-acquired it at the beginning of the 1st income year 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)**]