

Foreign Investment Fund (FIF) Taxation

What New Zealand Investors Need to Know

Author: Tim Doyle, CA

Doyle Accountants, Chartered Accountants



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Executive Summary

This whitepaper from Doyle Accountants examines the Foreign Investment Fund (FIF) tax regime in New Zealand. As international investment becomes increasingly accessible, understanding your tax obligations is essential for maximising returns and ensuring compliance. This whitepaper outlines the FIF rules, calculation methods, and exemptions and provides practical examples using well-known companies like Tesla and MicroStrategy to illustrate different scenarios.

It primarily focuses on the investor being a natural person or family trusts (not companies) and the two most common methods in practice, Fair Dividend Rate (FDR) and Comparative Value (CV).

Introduction

New Zealand's tax system requires residents to pay tax on their worldwide income, including returns from overseas investments. The Foreign Investment Fund (FIF) rules were implemented to ensure appropriate taxation of offshore assets, preventing tax avoidance through accumulating offshore earnings. These rules apply to most foreign investments outside of Australia, including shares, managed funds, and certain insurance products.

Understanding these rules is crucial for any investor with international holdings, as compliance failures can result in penalties and unexpected tax liabilities. At Doyle Accountants, we specialise in navigating these complex regulations while maintaining full compliance.



What is a foreign investment fund (FIF)?

A Foreign Investment Fund (FIF) refers to an interest in a foreign entity that you own as a New Zealand tax resident. This typically includes:

- Shares in foreign companies (outside Australia)
- Units in foreign unit trusts
- Foreign superannuation schemes (before withdrawal)
- Rights or options to acquire any of the above
- Certain foreign life insurance policies

Australian-listed investments are generally excluded from the FIF rules due to the Australia-New Zealand Closer Economic Relations agreement, which instead taxes only on dividends received.

When do the FIF rules apply?

The FIF rules apply when you hold investments that meet the FIF definition and exceed certain thresholds. However, several exemptions may apply:

De Minimis Exemption: If the total cost of all your FIF investments is less than NZ\$50,000, you may qualify for exemption from the FIF rules. In this case, you only pay tax on actual dividends received.

Australian Exemption: As mentioned, most investments in Australian resident listed companies are excluded from FIF taxation.

Certain Types of Investments: Some categories of foreign investments have specific exclusions or are covered by different tax regimes.



FIF income calculation methods

For investments subject to FIF rules, there are several methods available to calculate your taxable FIF income:

1. Fair Dividend Rate (FDR) Method

This is the most commonly used method, taxing 5% of the investment's opening market value each year, regardless of actual returns.

This can be a unique concept to understand: an investor returns an income of 5% of the opening market value despite not receiving that amount of income. It is a “fictional” or “notional”, or “deemed” return that you return as income, despite receiving no income (for shares that don’t pay dividends) or some dividend income. Any dividend income received is generally non-taxable.

2. Comparative Value (CV) Method

Taxes the actual change in market value plus distributions, calculating the difference between opening and closing values, adjusted for any purchases, sales, and income.

3. Cost Method

Similar to FDR but using 5% of cost basis rather than market value.

4. Deemed Rate of Return Method

Applies a prescribed interest rate to the investment's opening book value.

5. Attributing Interest Method

For certain controlled foreign companies where detailed financial information is available.

Most taxpayers use either the FDR or CV method, with specific rules determining when each can be applied.



Natural persons, family trusts and companies – different treatment

For investments subject to FIF rules, there are several methods available to calculate income. The FIF rules apply differently depending on the type of investor entity. The focus of this report is primarily on natural persons (individuals) and family trusts, where the most flexibility and planning opportunities exist.

For natural persons and family trusts, the FIF rules offer several advantages that companies don't enjoy. Individuals and family trusts can apply the de minimis exemption for investments under NZ\$50,000, allowing taxation only on actual dividends received. Additionally, these entities have greater flexibility in choosing between calculation methods, potentially switching between FDR and CV methods annually to optimise tax outcomes based on investment performance.

In contrast, companies face more restrictive FIF treatment. They cannot access the de minimis exemption regardless of investment size, meaning all foreign investments are subject to FIF taxation. Companies are generally required to use the FDR method at a 5% deemed rate, with limited ability to switch methods.

Family trusts, while similar to individuals in many respects, require careful planning around beneficiary distributions and timing to maximise tax efficiency when FIF income is involved.

If the FIFs are owned jointly (i.e., Husband and Wife), the cost base threshold is \$100,000 (i.e., \$50,000 each). The Husband and Wife can complete the calculations jointly, and each return their share of the FIF income in their tax returns.



Practical examples

Let's examine how FIF taxation works in practice using two popular investments: Tesla (TSLA) and MicroStrategy (MSTR).

Example 1: Investment Below \$50,000 (De Minimis Exemption)

Scenario: Sarah invests NZ\$30,000 in Tesla shares in January 2024. This is her only foreign investment.

Application: Since Sarah's total foreign investments are below NZ\$50,000, she qualifies for the de minimis exemption. She will only pay tax on actual dividends received from Tesla.

Outcome: Tesla historically pays no dividends, so Sarah has no taxable income from this investment until she sells the shares (at which point any gain may be taxed under other provisions if the investment was acquired with the purpose of disposal).

Example 2: Investment Above \$50,000 (FDR Method)

Scenario: Michael invests NZ\$75,000 in Tesla shares on 31 March 2024. The market value of these shares on 31 March 2025 (the next valuation date) is NZ\$90,000.

Application: With investments cost value exceeding NZ\$50,000, Michael must apply FIF rules. Using the FDR method:

- Taxable income for the year 31 March 2025 = 5% of opening value (from the prior financial year) = $5\% \times \$75,000 = \$3,750$

Outcome: Michael must include \$3,750 in his taxable income for the year, regardless of whether he received any dividends or sold any shares. At a 33% tax rate, this results in \$1,237.50 in tax.

Example 3: Multiple Investments

An individual or family trust cannot use a combination of the Fair Dividend Rate (FDR) and Comparative Value (CV) methods within the same income year for calculating FIF income. The rules require that the same method be applied consistently across all attributing interests in FIFs for that particular year. This means that if an individual chooses to use the FDR method for one investment, they must use it for all their FIF investments in that year, unless specific legislative provisions prevent them from doing so.



However, individuals and trustees of eligible trusts have the flexibility to switch between the FDR and CV methods in different income years. This allows them to choose the method that results in the lower tax liability for each year, but they must apply the chosen method consistently across all FIF interests for that year.

The rationale behind this requirement is to prevent manipulation of tax outcomes by switching methods within the same year, which could lead to inconsistent and potentially unfair tax results. Therefore, while individuals can choose between methods from year to year, they must adhere to a single method for all FIF interests within a given year.

Furthermore, it is the total cost of all FIFs that need to be considered. Even if each individual investment is below the \$50,000 minimum, the combined total cost value should be considered.

Scenario: Jennifer has the following investments as of 31 March 2024 with a cost value of >\$50k.

- Tesla shares: NZ\$60,000 (opening market value)
- MicroStrategy shares: NZ\$40,000 (opening market value)

During the year, Tesla's value increases to NZ\$72,000 and pays no dividends. MicroStrategy's value increases to NZ\$65,000 and pays dividends of NZ\$1,000.

Application: With total investments costing more than NZ\$50,000, Jennifer must apply FIF rules. She may choose between methods, but must apply the same method to both investments.

FDR Method:

- Tesla: taxable income = $5\% \times \$60,000 = \$3,000$
- MicroStrategy: taxable income = $5\% \times \$40,000 = \$2,000$
- Total taxable income under FDR method = \$5,000

CV Method:

- Tesla:
 - Closing value: \$72,000
 - Opening value: \$60,000
 - Dividends received: \$0
 - Taxable income = $(\$72,000 - \$60,000) + \$0 = \$12,000$
- MicroStrategy:
 - Closing value: \$65,000
 - Opening value: \$40,000
 - Dividends received: \$1,000



- Taxable income = $(\$65,000 - \$40,000) + \$1,000 = \$26,000$
- Total taxable income under CV method = \$38,000

Outcome: Jennifer has chosen the FDR method because it is the lower of the two methods.

Example 4: Quick Method Switch Analysis

Scenario: David owns Tesla shares (with a cost basis of \$70,000) worth NZ\$100,000 on 31 March 2024. By 31 March 2025, they're worth NZ\$80,000 with no dividends received.

Application:

- Income for the year ending 31 March 2025:
 - FDR Method income: $5\% \times \$100,000 = \$5,000$
 - CV Method income: $\$80,000 - \$100,000 = -\$20,000$

Outcome: David should use the CV method this year as it results in no taxable income (losses under CV cannot be claimed). This demonstrates the importance of method selection based on investment performance.



Record keeping requirements

Maintaining thorough records is essential for FIF compliance. You should keep:

- Purchase dates and costs for all foreign investments
- Market values at the beginning of each income year (31 March)
- Records of any sales, including dates and proceeds
- Dividend statements and other income distributions
- Exchange rates used for conversions

Strategic considerations for FIF investments

Understanding the FIF rules allows for strategic tax planning:

Timing of Purchases and Sales: The timing of transactions can affect your FIF income calculation, particularly with the FDR method.

Method Selection: Annual analysis of which calculation method is most advantageous can save significant tax dollars.

Investment Structure: In some cases, investing through PIE funds or other structures may provide tax advantages over direct foreign investment.

Currency Considerations: Exchange rate movements can impact both investment returns and tax calculations.



Conclusion

The FIF tax regime presents both challenges and opportunities for New Zealand investors. While compliance requirements are substantial, strategic application of the rules can lead to optimal tax outcomes that support your investment goals.

Our expertise in international tax matters at Doyle Accountants positions us to provide tailored advice for your specific investment portfolio. We work proactively to ensure compliance while identifying opportunities to minimise tax burden legally and ethically.

How Doyle Accountants can help

Our specialised services for foreign investments include:

- Comprehensive FIF calculations and advice on method selection
- Integration of FIF considerations into your broader investment strategy
- Annual tax preparation and filing for international portfolios
- Ongoing monitoring of regulatory changes that may affect your investments
- Strategic planning to optimise after-tax returns

Contact us today to schedule a consultation about your international investment portfolio and ensure you're making the most of your global opportunities while remaining fully compliant with New Zealand tax law.