Foreign investments - the new rules!

From 1 April 2007 taxpayers with investments in foreign lands face new and complex taxing rules. The rules apply to investments of less than 10% in most foreign companies, foreign units trusts, foreign life insurance policies, foreign investment vehicles and foreign superannuation schemes.
What follows is a general synopsis of the rules intended for general guidance and to assist in knowing what to ask an adviser.

The $50,000 Rule
The $50,000 rule applies to individuals. It does not apply to family trusts.
What the rule means is that if the total cost of all your foreign investments is less than $50,000 the new rules do not apply.
Instead you pay tax on dividends received and only pay tax on capital gains if you are a share trader or acquired the investments with an intention of sale.
There are rules for calculating what your "cost" is as at 1 April 2007 for the purposes of the exclusion.
When it comes to eligibility, if you are couple owning investments jointly you can share the value equally.

"Fair" Dividend Rate
The Government has decided that it is only "fair" that you pay tax on a deemed return of 5% per annum on your foreign investments rather than on the actual return.
This will be "fair" to the Government if the actual return is less than 5% and "fair" to you if the actual return is greater than 5%.
The 5% return is calculated on the value of your foreign investments as at 1 April each year starting from 1 April 2007.
This means that you pay tax on an investment even if you sell it during the year. On the other hand, you don't pay tax on an investment acquired during the year (unless you also sell it during the year) until the following year.
As the 5% is applied to the market value of the investment it is "fair" that you will be paying tax on capital growth in your investments and movements in the New Zealand dollar. As the New Zealand dollar is high at the present time you will suffer a tax cost when it falls.
It does however mean that tax will no longer be paid on dividends received. You will however still receive a credit for any tax deducted in the country where the dividend comes from.

Example	2007/2008	2008/2009
Opening value	100,000	108,000
Dividend received	4,000	6,500
FDR at 5%	5,000	5,400
Taxable income	5,000	5,400

On the other hand, if you or your family trust can show that the return on investments is less than 5% an alternative method of calculating the taxable income can be used and no tax is payable in a year that there is a loss.

The New Zealand Rule
The new rules do not apply to New Zealand investments so you will still pay tax on dividends received from New Zealand companies and capital gains will be exempt from tax unless you are a share trader or acquired the shares with an intention of sale.

The Australia Rule
There is an exclusion for investments in Australia - but not all investments as some may think.
The exclusion only applies to shares in companies included in the All Ordinaries Index of the Australian Stock Exchange ("ASX"). To qualify the All Ordinaries Index ASX company must be Australian tax resident (and some are not), cannot be tax resident in another country (and some are) and must maintain a franking credit account (and some including listed unit trusts) do not.

There are currently about 477 'companies' in the All Ordinaries Index and the number changes as companies come and go. We understand at least 32 current members do not qualify for the exclusion.
This means in one year an investment could be excluded and the next year it is not!

The GPG Rule
If you own shares in Guinness Peat Group plc they will not be subject to the new rules for 5 years.

The "Quick Sale" Rule
Should you buy and sell investments in the same year you will pay tax on the lesser of:

- the gain on sale; and
- 5% of the average cost of the investment.

Traders and Active Investors
If you are a trader or active investor there are special rules as you will no longer have to pay tax on gains on disposal. Neither will you receive a deduction for any losses.
The special rule then is that you are deemed to have disposed of your investments on 31 March 2007 at market value.
If this 'disposal' results in a loss you will get a deduction in the 2007/2008 tax year.
If this 'disposal' results in a profit you will pay tax on the profit by spreading it over the 2008, 2009 and 2010 tax years.
You need to obtain valuations of your foreign investments as at 31 March 2007 if this rule applies to you.

PIE'S
No we don't mean New Zealand iconic food but collective investment vehicles such as unit trusts.
If you have invested through a collective investment vehicle and it elects to become a PIE you will hear from them with regard to the taxation consequences.
This regime commences from 1 October 2007.

Important Notice
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