KPMG

New Zealand

Taxation

FUNDS AND FUND MANAGEMENT 2010

3.0 Taxation

The regime that governs the taxation of collective investment vehicles has undergone significant changes with the introduction of new tax rules for entities that elect to become Portfolio Investment Entities (PIEs). As the PIE regime is optional, those investment funds that do not elect to become PIEs will continue to be taxed under the rules that applied prior to the introduction of the PIE rules. Both tax systems for collective investment vehicles are discussed in further detail below.

Parallel to the introduction of the PIE regime, there were changes to the general rules governing the taxation of international portfolio equity investments (that is, equity investments of less than 10 percent). The Fair Dividend Rate (FDR) method, introduced for such investments, taxes a fixed rate of return of 5 percent of the market value of investments held by an investor. The FDR method acts as a proxy for taxing the actual returns on international portfolio equity investments (including dividends).

These tax changes were designed to clarify the investment taxation rules, to accommodate KiwiSaver, a voluntary work-based savings scheme for New Zealand employees which was introduced in 2007. KiwiSaver is open to all New Zealand employees and provides an opportunity for the employee to make set contributions from their gross earnings into an approved private investment scheme.

The 2008-09 year reduction in the company tax rate, to 30 percent (from 33 percent), applies equally to widely-held savings vehicles (including PIEs). Widely held savings vehicles are broadly collective investment vehicles, such as unit trusts and superannuation schemes, with a minimum of 20 investors with restrictions on the level of investment by a single investor (typically limited to 20 percent of the fund).

Personal tax rates have also been reduced and tax thresholds increased with effect from 1 April 2009. These changes will be reflected in the marginal tax rates on savings, from 1 April 2010, including investment tax rates under the PIE regime.

AUDIT ▪ TAX ▪ ADVISORY

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The taxation system for collective investment vehicles continues to be a complex area for managed funds to navigate. In addition to the major taxation reforms in 2007, which continue to have significant ongoing impacts on the taxation of funds under management, providers have also had to contend with changes to New Zealand's tax regime for life insurance, including the savings component of various life policies, which apply from the 2010-11 income year. As was the case with the PIE, FDR and KiwiSaver changes, providers and tax advisors have carried out considerable work to ensure a smooth transition to the new rules.

3.1 Taxation of funds

Collective investment funds in New Zealand are typically structured as unit trusts, group investment funds, or superannuation funds. KPMG in New Zealand discusses the tax treatment of each below. A number of unit trusts and superannuation funds have chosen to become PIEs. Collective investment vehicles that have not opted to become PIEs are taxed under the different entity tax regimes that existed prior to the introduction of the PIE regime.

Portfolio investment entities

Collective investment vehicles (that is, unit trusts, group investment funds, and superannuation funds) that meet certain ownership and investment criteria can elect to enter into the PIE regime. Other entities such as listed companies and defined benefit funds are also eligible to become PIEs. There are a number of different variants of the PIE tax model, which are discussed below.

PIEs will generally not be taxed on any realized gains arising from the disposal of shares in New Zealand companies or certain Australian resident listed companies.

Collective investment vehicles (other than listed companies and defined benefit funds) that elect to become PIEs cease to fall within the usual tax rules.

Portfolio tax rate entities ('multi rate PIEs")

These entities are technically referred to as portfolio tax rate entities (multi-rate PIEs from 1 April 2010) and are the most common variant of PIE.

Such a PIE's tax liability is calculated by reference to the tax rates of its investors. Any income derived by a multi rate PIE effectively flows through to the underlying investors and, in the case of individual investors, is taxed in the entity at investors' personal tax rates, currently capped at 30 percent.

From the investor's point of view, they receive these net gains tax-free and do not need to return this income in their tax return, if the correct tax rate has been supplied. Resident entity investors (such as companies and trusts) do not

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have tax paid on their behalf by the multi rate PIE and instead must account for tax on PIE income in their own tax returns. Certain organizations that derive exempt income (such as charities) have tax paid at 0 percent on their behalf by a multi-rate PIE. This provides these organizations with a significant incentive to invest in multi rate PIEs over other types of investments such as non-PIE unit trusts (see below, that generally distribute tax-paid income with imputation credits attached which these organizations cannot utilize).

The PIE tax deducted on investors' behalf represents a final withholding tax for individuals (to the extent they have elected the applicable tax rate) as it is designed to tax investors at their correct personal tax rates. Tax withheld by a multi rate PIE must be allocated to each investor and can be deducted from the investors' ownership interests or withheld from distributions to investors to reflect the economic liability for taxation vesting with the investor.

A multi rate PIE is not allowed to maintain an imputation credit account - this means that any tax paid by the entity will not generate any imputation credits. This is in contrast to entities that elect to become portfolio listed companies.

Portfolio listed companies (listed PIEs)

The rules differ for PIEs that are listed on a recognized exchange in New Zealand. These entities are technically known as portfolio listed companies (listed PIEs from 1 April 2010) and are required to maintain an imputation credit account and must attach full imputation credits (to the extent available) to distributions. Un-imputed distributions from listed PIEs are non-taxable.

Unlike a portfolio tax rate entity, a listed PIE pays tax at the company rate of 30 percent. Dividend income derived by shareholders from a listed PIE is generally excluded income (except where the recipient is a company or other fund, in which case the income is taxable but only to the extent imputed).

Portfolio defined benefit funds (benefit fund PIEs)

Defined benefit funds can elect to become a portfolio defined benefit fund (a benefit fund PIE from 1 April 2010), and be taxed at a flat 30-percent rate (similar to a listed PIE). Distributions from such funds are excluded income.

Unit trusts

The Income Tax Act 2007 defines a unit trust as any scheme or arrangement that is made for the purpose or has the effect of providing facilities for subscribers, purchasers, or contributors to participate, as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust. Specifically excluded from the definition are:

- a trust for the benefit of debenture holders;

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- the common fund of public trust;
- any group investment fund established by public trust;
- the common fund of the Maori trustee;
- any group investment fund established under the Trustee Companies Act 1967;
- any friendly society registered under the Friendly Societies and Credit Unions Act 1982;
- any superannuation fund;
- any employee share purchase scheme;
- any fund with the sole purpose of the payment of employees' funeral expenses; and
- any other trust that is declared by the Governor General of New Zealand not to be a unit trust.

For tax purposes, a unit trust is deemed to be a company (except where the entity becomes a PIE, in which case special tax rules apply – see above). Units are deemed to be shares, unitholders are deemed to be shareholders, and distributions to unitholders are deemed to be dividends.

Where a unit trust does not become a PIE, the trustees of the unit trust are taxed and liable to income tax as agents of the unit trust. As such they are subject to a flat tax rate of 30 percent, the prevailing company tax rate.

The taxable income of a unit trust generally includes profits and losses from the sale of investments. However, this is a question of fact and some (passive/index) equity trusts have obtained binding rulings from the New Zealand Inland Revenue that such gains/losses are not taxable. With changes to New Zealand's international tax rules, however, the scope for such rulings has been limited to investments in certain Australasian equities.

In accordance with its treatment as a company, a unit trust is required to maintain an imputation credit account under the dividend imputation rules. Imputation credits can therefore be attached to distributions made to unitholders, so that a double tax impost is not suffered on income earned by the unit trust. Similarly, distributions of capital are generally not taxable under special rules on redemption of units from a unit trust.

There are special concessional continuity rules for public unit trusts (broadly defined as widely-held unit trusts) that treats all unitholders as a notional single person. This allows the carry forward of imputation credits and tax losses even if the investors in the fund change over time.

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There are rules allowing for the transfer of excess expenses between investment vehicles. Excess expenditure incurred by a fund can be transferred to a fund it invests in. The transferred expenditure reduces the ultimate tax liability of the fund receiving the expenses. The tax benefit of the expense transfer is typically reflected in additional units being issued to the investor fund.

Group investment funds

A group investment fund (GIF) is established pursuant to the Trustee Companies Act 1967. Historically, forming a GIF enabled a trustee company to gather the funds of many smaller investors into an administratively efficient entity. Broadly speaking, for tax purposes the assets and income of a GIF are allocated into two categories dependent on the nature of the investors. The taxation of a GIF that is not a PIE depends on which of the two categories, A or B, its income can be attributed to.

Category A income is taxed in the hands of the trustee at 30 percent for widely-held GIFs. Distributions are deemed to be dividends, as if the GIF were a company for tax purposes and the investors held shares in the company. In this regard, the GIF is analogous to a unit trust. Category A income is anything which is not Category B income.

Category B income is taxed as if the GIF were a qualifying trust. Accordingly, income is divided into either trustee income or beneficiary income. Beneficiary income is taxed in the hands of the investor (at the investor's marginal tax rate), rather than the GIF (the trustee is taxable at 33 percent). As a result, if a Category B investor is tax exempt and that investor's share of the income can be designated as beneficiary income, no tax will be payable. The funds in a GIF give rise to Category B income to the extent that the current value of the funds is derived from designated sources.

The definition of designated sources includes:

- a trust that is created by will, intestacy, order of Court, or for the purpose of administering funds being compensation or other money arising from the death of, or injury to, any person; or

- a trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner of Inland Revenue, applied, wholly or principally, for benevolent, philanthropic, cultural, or public purposes within New Zealand.

It is important to note that in each case, the trustee of the GIF must also be a trustee of the other trust. Most investors will be Category A investors. However, a GIF can become a Designated GIF and be treated as a Category B income Fund, regardless of the nature of its investors, if it invests only into a limited and specified range of securities.

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Superannuation schemes

Most New Zealand based superannuation schemes are legally established as trusts and are registered under the Superannuation Schemes Act 1989. These schemes are designated superannuation funds for tax purposes. A superannuation scheme constituted outside New Zealand does not meet the superannuation fund definition. Non-registered superannuation schemes usually fall within the meaning of unit trust.

A superannuation fund's income is subject to tax at the rate of 30 percent for widely-held superannuation funds that do not elect to become PIEs. The taxable income of a superannuation fund generally includes profits and losses from the sale of investments. However, as in the case of unit trusts this is a question of fact and some (passive/index) funds have obtained binding rulings from the New Zealand Inland Revenue that such gains/losses are not to be included in the taxable income calculation. These binding rulings are now generally limited to Australasian shares. In contrast, unit trusts and superannuation schemes that become PIEs are explicitly not taxed on gains on the sale of New Zealand and certain Australian shares thereby largely precluding the need for such rulings. Distribution of benefits from a superannuation fund is received tax free in the beneficiary's hands.

There are rules allowing for the transfer of expenses between superannuation funds. This is most commonly used when a retail superannuation fund derives a tax paid return from investments in wholesale funds and thus derives no benefit from deducting any expenses. These expenses include costs incurred in developing, marketing, selling, promoting, and advertising for members.

KiwiSaver

The KiwiSaver regime is a voluntary work-based savings scheme for employees, designed to increase the level of savings and investment of New Zealanders. The KiwiSaver regime was introduced with effect from 1 July 2007.

KiwiSaver must be offered by all employers and is voluntary for all new full-time and part-time employees aged between 18 and 65 (enrolment is automatic unless the employee opts out). Contributions will generally be deducted from employees' salary and wages (referred to as gross earnings) at a specified rate. Gross earnings includes salary or wages and other employment-related taxable allowances, such as bonuses, commissions, extra salary, gratuities, overtime, and other remuneration. There is a matching compulsory employer contribution requirement.

There have been a number of recent changes to the KiwiSaver regime (these changes took effect from 1 April 2009):

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The minimum employee contribution rate has fallen from 4 percent to 2 percent of gross earnings (although 4 percent or 8 percent contribution options are still available).

The minimum employer contribution rate has correspondingly been reduced to 2 percent to match the lower minimum employee contribution (with the tax exemption on employer contributions also limited to the new contribution level).

A tax credit of up to NZD 1,040 per annum per employee (which was payable to employers to partially compensate them for their compulsory contributions) has been discontinued. The tax credit of up to NZD 1,040 per annum paid to employees in KiwiSaver (the member tax credit) remains however.

Under the KiwiSaver regime, employee (and employer) contributions are invested in the employee's choice of one of a number of approved KiwiSaver investment schemes. If no choice is made, the employee's contributions are invested in one of a number of default funds. Contributions to the scheme will be eligible for withdrawal when the employee reaches 65 (or earlier in exceptional circumstances).

A KiwiSaver scheme may be a PIE but this is not compulsory (except in the case of a default KiwiSaver fund).

Trans-Tasman portability of superannuation savings

In 2009, the Governments of New Zealand and Australia reached agreement to facilitate greater portability of superannuation savings between the two countries.

The agreement is designed to allow New Zealanders working in Australia to transfer their Australian superannuation contributions to a KiwiSaver scheme, on their return to New Zealand (and vice versa for Australians working in New Zealand). At present, these savings are locked-in, until retirement age is reached, in Australia.

The key features of the agreement will allow for:

The transfer of retirement savings between the two countries to be exempt from entry and exit taxes. Under current tax laws, transferring savings from Australia to New Zealand may be regarded as a taxable dividend.

KiwiSaver members moving from New Zealand to Australia to retain any member tax credits if they transfer to an Australian scheme.

Retirement savings transferred from Australia into a New Zealand KiwiSaver scheme to be withdrawn when members reach the age of 60 as long as they have retired. KiwiSaver savings transferred to Australian schemes can be withdrawn when members reach 65.

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Legislation to give effect to the above was introduced in a Taxation Bill in November 2009.

Taxation of international equity investments

The FDR rules, under New Zealand's foreign investment fund rules, generally apply to an investment by a New Zealand resident, including collective investment vehicles such as PIE, in a foreign company when the investor owns less than 10 percent of the company. The FDR rules apply from income tax years commencing on or after 1 April 2007.

FDR method

The FDR method broadly taxes 5 percent of a portfolio's opening market value each year. There is also a quick-sale adjustment for investments that are purchased and then sold during an income year. The quick sale adjustment taxes the lesser of 5 percent of the cost of the shares that were sold or the actual gain on the transaction (losses are capped at zero).

There are special concession for individuals and family trusts holding offshore investments - if the total (realized and unrealized) return on the share portfolio subject to the FDR rules is less than 5 percent then they can pay tax on the lower amount (that is, they pay no tax if the shares make a loss but are not allowed any deductions in relation to this loss).

In contrast, where the FDR method is applied by a PIE or other collective investment vehicle (or a company generally), tax is payable on the deemed 5-percent return irrespective of the actual performance of the offshore share portfolio.

Exclusions from the FDR method

The FDR method is not allowed to be used in certain circumstances (for example, where an offshore investment guarantees a return in excess of 5 percent, is a fixed rate share, or offers a debt like return that is effectively hedged to the NZD, to remove any currency risk). Such investments are generally taxable on distributions and realized and unrealized changes in market value (this is called the comparative value method under New Zealand's foreign investment fund rules). The New Zealand Inland Revenue also has the power to deem the FDR method to not be applicable to a particular investment (as well as deem an excluded investment to be subject to the FDR method).

Exemptions from New Zealand's foreign investment fund rules

Investments in Australian-resident companies listed on an approved index of the Australian Stock Exchange, such as the All Ordinaries Index (the 500 largest ASX-listed companies) are taxed the same as New Zealand investments. The

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FDR method does not apply to such shares. Instead they are taxable on dividends if the investment is held on capital account or on dividends and realized gains if held on revenue account. Trading gains on such shares are not taxable for a PIE. The New Zealand Inland Revenue publishes, each year, a list of investments that qualify for this exemption (available at www.ird.govt.nz).

For natural person investors, if the total cost of their offshore investment holdings is NZD 50,000 or less, these investments are taxable under general income tax rules that apply to NZ investments (for example, on dividends only if held on capital account). Again, the FDR rules do not apply to the applicable investors' holdings.

Rules for non-controlling interests of 10 percent or more

Where an individual investor holds a 10 percent or greater non-controlling interest in a foreign entity resident in Australia, Canada, Germany, Japan, Norway, Spain, the United Kingdom, and the United States (the grey list of countries), different tax rules apply. Investments in these grey list of countries will generally be taxed in the same manner as a New Zealand investment.

This treatment does not however apply to collective investment vehicles. (For example, the FDR method applies to 10 percent and greater holdings by PIEs and other New Zealand funds in foreign widely-held investment vehicles resident in grey list countries)

For 10 percent or greater non-controlling investments in non-grey list countries, the comparative value method of taxation will generally be applicable. Alternatively, tax is payable on the investor's share of the underlying income of the entity, treated as if it were a NZ resident (under the branch equivalent taxation method).

Controlled foreign company rules

A controlling interest in a foreign company arises where a single NZ investor owns 40 percent or more, or five or fewer NZ investors own 50 percent or more, of the company.

Until recently, the rules for interests in controlled foreign companies (CFCs) mirrored those for non-controlling interests of 10 percent or more (see above). However, for income years beginning on or after 1 July 2009, an exemption applies if the offshore CFC derives predominantly active income (that is, derives less than 5 percent passive income, such as interest, dividends, rents, and royalties).

CFCs that fail the active income test continue to be taxed under the branch equivalent method – see above. There is a limited exemption if the CFC is resident in Australia.

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Dividends paid by the CFC are not separately taxable, under the new rules.

Income Tax Act re-write

A program has been in place to progressively rewrite certain parts of the New Zealand income tax legislation. The intention is not the change the effect of any provision unless explicitly signaled. This program was completed with the enactment of the Income Tax Act 2007, which has effect for the 2008 - 2009 income tax year onwards.

The Income Tax Act rewrite did not initially encompass the PIE provisions. However, a rewrite of these provisions has recently been completed and will take effect from 1 April 2010.

3.3 Taxation of resident unitholders/investors in a resident fund

Portfolio investment entities

As discussed above, PIE income will be subject to tax at investors' marginal tax rates, capped at 30 percent (for PIEs other than listed PIEs and defined benefit funds).

Where individual investors are concerned, no further liability should arise if the investor has provided their correct tax rate to the PIE. The tax rates for individual investors are based on the investor's taxable income, and their combined taxable and PIE income, in one of the two previous income years. The current rates and thresholds are:

Total Taxable Income	Combined Taxable and PIE Income	Rate (%)
NZD 0 to 38,000	NZD 0 to 60,000	19.5
NZD 38,001 +	NZD 60,001 +	30

From 1 April 2010, the applicable tax rates will be as follows:

Total Taxable Income	Combined Taxable and PIE Income	Rate (%)
NZD 0 to 14,000	NZD 0 to 48,000	12.5
NZD 0 to 48,000	NZD 0 to 70,000	21
NZD 48,001 +	NZD 70,001 +	30

Resident entity investors (such as companies and trusts) will be allocated their share of PIE income and will need to return this income in their own tax returns (that is, will have a 0 percent rate applied). As previously discussed, this also provides certain organizations that derive exempt income (such as charities)

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with a significant incentive to invest in multi rate PIEs over other types of investments such as non-PIE unit trusts.

Investors in multi rate PIEs that are trusts can elect to have tax withheld at 30 percent (or lower in certain circumstances).

As tax is payable on PIE income as it accrues, the income when actually distributed will generally be available tax-free to all investors.

As mentioned earlier, the rules differ to some extent for PIEs that are listed on a recognized exchange in New Zealand (known as listed PIEs). Distributions from a listed PIE will generally not be taxable if received by individuals (and taxable only to the extent imputation credits are available to meet an investor's tax liability in the case of other investors).

Distributions to beneficiaries of defined benefits funds that become PIEs are also not taxable.

If an investor in a PIE holds their PIE investment on revenue account and on-sells the investment (that is, does not redeem the investment with the fund manager), any gain/loss realized upon the on-sale may be taxable to the investor.

Unit trusts

Where a unit trust does not become a PIE, any distribution of income or gains of the fund to unitholders will be taxed as a dividend. Unitholders (like shareholders) are entitled to a credit for any New Zealand tax paid by the fund on receipt of distributions that are imputed (that is, have imputation credits attached).

Where units are sold (rather than redeemed), while there is no comprehensive capital gains tax in New Zealand, a unitholder will be subject to tax on any gains where the units were acquired with the intention or purpose of sale, as part of a profit making scheme, or the unitholder is in the business of dealing in units.

The redemption (or cancellation) of units in a unit trust is taxed as a dividend. However, the dividend portion of the proceeds is limited to the extent that the proceeds exceed the available subscribed capital (ASC) able to be attributed to the unit.

The ASC of a unit trust is essentially the amount paid in consideration for the issue of units in that unit trust. This amount can be distributed tax free to shareholders upon redemption of those units (as it represents the initial capital invested).

The amount of ASC able to be attributed to each unit on redemption will depend on whether the units were issued subject to the ordering rule or the

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slice rule. Unit trusts have the option available to them as to which rule they would prefer to use.

The ordering rule applies to unit trusts in the same way in which it applies to shares in ordinary companies. It provides that if there is sufficient ASC for the class of units being redeemed then the proceeds of the redemption will not be a taxable dividend. The ordering rule is, therefore, analogous to a profits last distribution rule.

The slice rule excludes from tax that part of the distribution that does not exceed the ASC per share. As such, every redemption will give rise to a distribution of capital and a taxable distribution of income.

Group investment funds

Where a group investment fund does not become a PIE, distributions of Category A income are deemed to be dividends, as if the GIF were a company for tax purposes and the investors held shares in the company. In this regard, the GIF is analogous to a unit trust.

A GIF can elect to maintain an imputation credit account to enable it to impute distributions to Category A shareholders so that they receive credits for any tax paid by the GIF.

Where units in a GIF are sold (rather than redeemed), similar to the sale of units in an ordinary unit trust, the unitholder will be subject to tax on any gains where the units were acquired with the intention or purpose of sale or the unitholder is in the business of dealing in units.

The redemption (or cancellation) of units in a GIF is also taxed identically to the redemption of units in an ordinary unit trust as detailed above.

Category B income is taxed as either trustee income and taxed at 33 percent or, if distributed or applied to beneficiaries within prescribed time periods, is taxed to the beneficiary at their marginal tax rate as beneficiary income. Accordingly, if a Category B investor is tax exempt and that investor's share of the income can be designated as beneficiary income, no tax will be payable.

Superannuation schemes

A superannuation fund that does not become a PIE is taxed as a trust. Distributions, however, do not constitute beneficiary income and are treated as tax free in the hands of the investor.

Contributions by individuals to superannuation funds are out of tax paid income and therefore not separately taxable. Employer contributions are however generally subject to employer's superannuation contribution tax (ESCT). ESCT enables a 5-percent saving for those on the highest marginal tax rate of 38

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percent. However, in some situations a 5-percent additional tax is payable by the superannuation fund on early withdrawal of the funds by the member.

KiwiSaver

The taxation of a KiwiSaver scheme depends on the structure of the scheme and whether the entity elects to become a PIE.

As savings in KiwiSaver schemes are locked-in until retirement, distributions to investors will typically be reinvested. These amounts will typically be tax-free where the KiwiSaver scheme is a PIE. Where the KiwiSaver scheme does not become a PIE, any reinvested distributions will be taxed as discussed above for non-PIE funds. Most, if not all, KiwiSaver schemes have elected to become PIEs.

Employer contributions to KiwiSaver schemes are exempt from tax (ESCT) subject to a cap for contributions. The cap is the lesser of the employee's contribution to KiwiSaver or 2 percent of their gross earnings.

3.5 Taxation of resident unitholders/investors in a non-resident fund

Unit trusts

Where a New Zealand resident invests in a non-resident unit trust, the tax treatment of that investment will depend on whether the investment is a portfolio (that is, a less than 10 percent) investment or a non-portfolio investment. Most offshore holdings by New Zealand collective investment vehicles, including PIEs, will be portfolio investments.

If the holding is a portfolio investment in a foreign unit trust, for example, the new FDR rules would generally apply to the investment – see earlier. However, depending on the investments of the non-resident fund (for example, 100-percent NZD denominated or hedged debt investments) the comparative value method may be applicable instead.

Non-portfolio (that is, greater than 10 percent) investments in foreign widely-held investment vehicles are also taxable under the FDR method where the investor is a NZ collective investment vehicle, such as a PIE.

Different rules apply for other (non-fund) investors with greater than 10 percent holdings.

Non-controlling investments by individuals and companies would generally be taxable on distributions (and in certain cases gains and losses on the sale of units may also be brought to tax). This rule applies to share investments in so-called grey list countries only (discussed earlier on, which represents the

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majority of New Zealand's major trading partners). Investments in non-grey list countries would be taxed on the realized and unrealized change in value each year, under the comparative value method

New Zealand company investors with such investments in foreign companies are subject to a foreign dividend payment liability of 30 percent in lieu of being taxable on the dividend. The foreign dividend payment rules have been repealed for income years beginning on or after 1 July 2009 (this change aligns with the new CFC rules).

Any tax deducted in the country of source on distributions will typically be allowed as a credit against New Zealand tax payable on the investment (either under FDR or on the actual distribution), to the extent that New Zealand tax is actually payable.

New Zealand's CFC rules previously taxed residents on undistributed income from their foreign subsidiary operations in certain circumstances (with a credit for tax paid by the subsidiary in the foreign jurisdiction).

Under the recent changes, however, CFCs deriving active income will not be taxed, including on distribution of profits to the NZ parent. Passive CFC investments, which will generally include investments in foreign unit trusts, will continue to be taxable in New Zealand on attributed foreign income.

Group investment funds

GIFs are creations of New Zealand statutes. There are no non-resident GIFs.

Superannuation schemes

The taxation of interests in non-resident superannuation schemes is a complex area of New Zealand tax law. Depending on the nature of the scheme (such as employer funded or not), the circumstances of the investor (such as recently qualified as New Zealand tax resident), and residency of the scheme, it could be taxed as any of the following:

- An interest in a foreign investment fund, in which case an investor would be taxed on the change in market value of their interest in the scheme each year (under the comparative value method) or under the FDR method, if applicable; or

- A trust – foreign, qualifying or non-qualifying as the circumstances dictate. The classification will impact on the extent to which distributions from the scheme are taxed, and the tax rate applying.

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3.6 Taxation of non-resident unitholders/investors in a resident fund.

The following outlines the tax treatment of non-resident investors in New Zealand managed funds, including those that become PIEs.

Portfolio investment entities

Non-resident investors in multi rate PIEs have tax deducted at a flat rate of 30 percent, irrespective of whether the non-resident is an individual investor or an entity (such as a company or trust). Distributions from the PIE to non-resident investors are not separately taxable.

Unit trusts

As a unit trust is deemed to be a company for tax purposes, distributions made to unitholders are taxed as dividends (except where the unit trust becomes a PIE).

Where a unitholder is a non-resident, the distribution will be subject to non-resident withholding tax (NRWT). The rate of NRWT is 30 percent, although this percentage may be reduced if the dividend is fully imputed or pursuant to a double tax agreement (DTA), generally to 15 percent.

New Zealand has recently negotiated lower NRWT rates on dividends with the United States, Australia and Singapore (with NRWT rates to be reduced to 5 percent and 0 percent in specific circumstances). Ratification of the new DTAs containing the lower NRWT rates is expected in early 2010.

Non-resident unitholders are provided with relief from double taxation (that is, as the unit trust is taxed at the company tax rate and withholding tax is deducted from dividends paid to non-resident unitholders) by way of a supplementary dividend and a Foreign Investor Tax Credit (FITC) mechanism. Where the dividend is fully imputed, the supplementary dividend absorbs the withholding tax cost to the investor in full. The NRWT is payable by the unit trust paying the dividend and a tax credit (the FITC) is claimed in the income tax return for the period the dividend is paid.

However, with the negotiation of lower NRWT rates on dividends under recent updates to New Zealand's DTAs (including 0 percent in certain circumstances), the FITC mechanism has been repealed with effect from 1 February 2010. Retaining FITC would result in some non-resident investors receiving a credit for New Zealand NRWT when no withholding liability arises. FITC is replaced by a 0 percent NRWT under New Zealand domestic law, when a dividend is fully imputed. This is designed to ensure that non-resident investors are no worse off, from a NZ tax perspective, under the repeal of FITC.

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The redemption of units in a unit trust is taxed as dividend income. However, the dividend portion of the proceeds is limited to the extent that the proceeds exceed the ASC able to be attributed to the unit. The dividend portion paid to non-resident unitholders will be subject to NRWT (subject to the applicable rate, under New Zealand domestic law, and the DTAs).

Imputation credits attached to the distribution are not available to reduce the liability to NRWT unless the credit is a special type of imputation credit.

Group investment funds

Category A GIF income is taxed in the same way as the income of a unit trust.

Category B income is taxed as either trustee income and taxed at 33 percent or beneficiary income (taxed at the beneficiary's marginal tax rate). A non-resident beneficiary will be liable to New Zealand tax on beneficiary income, as it will have a New Zealand source.

Superannuation schemes

Distributions by a New Zealand resident superannuation fund to a non-resident investor will be free from New Zealand tax in the hands of the investor.

3.7 Taxation of fund management/custodian companies

The fund manager will be subject to tax in the same manner as any other resident company. Any profits derived by the fund manager will, therefore, be subject to tax at the corporate tax rate, which is currently 30 percent. Any dividend that is derived in respect of the redemption or cancellation of units in a unit trust by the manager of a unit trust will be subject to the same rules that apply to other investors. Therefore, the manager may receive a taxable dividend if, for example, the unit trust being invested in is not a PIE and has run out of ASC, or those units were redeemed under the slice rule. Imputation credits would ordinarily offset that tax liability, although the credits are not available for distribution to the manager's own shareholders.

Custodian companies can elect to become portfolio investor proxies (PIE proxies) with respect to PIEs that investors in the custodian company invest in. A PIE proxy must take on the obligations of the PIE (such as the deduction of PIE tax, its payment to the New Zealand Inland Revenue and the adjustment of investor holdings to reflect the tax deducted) in respect of its investors.

3.8 Goods and services tax

Financial services are exempt from goods and services tax (GST). Management of a superannuation fund is deemed to constitute a financial service and

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associated fees are therefore not subject to GST. The situation is less clear in relation to management fees charged by fund managers to unit trusts and group investment funds for administration and investment management. For reasons of practicality and simplicity, GST is generally paid on a portion of the management fees charged by the fund managers.

Effective 1 January 2005 New Zealand has implemented a reverse charge on imported services for GST purposes. This is expected to impact mainly on financial service providers. It could also impact on investment funds obtaining administrative and management services from offshore.

Coupled with the introduction of the reverse charge the GST Act has been amended to allow the zero-rating of certain financial services provided to GST registered business recipients.

3.9 Entitlement to income

The timing of a unitholder's entitlement to income of the fund depends on the terms of the trust deed. The trust deed will set out the circumstances/conditions under which unitholders will be entitled to a distribution. An entitlement to income will not arise until the conditions set out in the trust deed are satisfied.

For PIE tax purposes, the recognition of income (and losses) in the entity has been aligned with the recognition of such income for financial reporting or unit pricing purposes by the entity. For the purposes of allocating income/loss to individual unitholders or members, this is based on investor entitlements as outlined in the terms of the trust deed. The recognition of income by the entity is likely to differ to when amounts are paid out to investors. A multi-rate PIE is required to deduct tax from unitholders' allocated income, and reflect this either at the time of distribution or in the value of investors' unit holdings. The income is not separately taxed again on distribution.

Where the entity is not a PIE, for income tax purposes, income arises to unitholders' at the date that the actual distribution takes place (either by a cash payment or by reinvestment of the proceeds). If tax has been paid by the unit trust on distributed income, this may be available as an imputation credit to offset shareholder tax liabilities.

3.10 Double tax agreements (DTA)

The provisions of New Zealand's DTAs will generally apply to unit trusts in the same manner as they apply to any other company.

New Zealand has entered into DTAs with the following countries. The applicable NRWT rates on dividends, under current DTAs are:

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Country of Residence	Rate
Australia*	15 f
Austria	15 f
Belgium	15 f
Canada	15 f
Chile	15 f
China	15 f
Czech Republic	15 f
Denmark	15 f
Fiji	15 f
Finland	15 f
France	15 f
Germany	15 f
India	15 f
Indonesia	15 f
Ireland	15 f
Italy	15 f
Japan	15 f
Korea, Republic of	15 f
Malaysia	15 f
Mexico	15 f
Netherlands	15 f
Norway	15 f
Philippines	15 (companies), 25 (others)
Poland	15 f
Russian Federation	15 f
Singapore*	15 f
South Africa	15 f
Spain	15 f
Sweden	15 f
Switzerland	15 f
Taiwan	15 f
Thailand	15 f
United Arab Emirates	15 f
United Kingdom	15 f
United States*	15 f
Other countries	30 f +

f This means the NRWT is the final liability. As long as the income has the correct NRWT deducted at source and it is the recipient's only income received from New Zealand, they do not need to file a New Zealand tax return.

* These DTAs have been renegotiated, reducing withholding tax rates on dividends when ratified. See below.

+ This reduces to 15 percent if the dividend is fully imputed (or fully dividend withholding payment credited).

New Zealand recently completed renegotiation of its DTAs with the United States, Australia, and Singapore. The changes, which are awaiting ratification, include reductions in the NRWT rate on dividends as follows:

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Current	New U.S. and Australia DTAs	New Singapore DTA
15 percent	0 to 10% shareholding – 15 10 to 80% shareholding – 5 80%+ shareholding – 0	0 to 10% shareholding – 15 10 to 100% shareholding – 5

Note: The new DTAs contain comprehensive limitation on benefits provisions, which restrict the benefits of the lower NRWT rates to residents of the signatory countries.

Renegotiation of New Zealand's DTAs with the United Kingdom and Canada will commence in early 2010.

3.11 Other tax-favored vehicles

None.

The Government is considering an option whereby non-resident investors investing offshore through PIEs can elect a 0-percent tax rate, on investment income. However, to date, no concrete proposals have been released for consultation.

3.12 Transfer taxes, stamp duty, and capital duty

There is no wealth or inheritance tax in New Zealand. Unitholders in a New Zealand fund may be liable for gift duty if full consideration is not paid for units and the gift or gifts made in any 12-month period exceeds NZD 27,000.

No capital tax is levied on the issue of units by a unit trust.

No transfer tax/stamp duty is payable on the sale and purchase of shares by a New Zealand unit trust.

3.13 Other developments in 2009/10

In 2009, the Government appointed an independent Tax Working Group (comprising leading tax academics, tax professionals and tax policy officials) to consider the medium-term challenges facing the New Zealand tax system, and how best to address these issues. KPMG in New Zealand was represented on the Tax Working Group through senior partner Paul Dunne.

The Tax Working Group's key focus was to identify policies to create a world class tax system to position New Zealand for recovery after the Global Financial Crisis.

The Tax Working Group's areas of consideration have included the personal, company and indirect tax systems.

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At the time of writing, the Tax Working Group has presented its recommendations to Government.

The recommendations have implications for savings, as the general consensus of the Group was to change the tax mix away from more harmful taxes (particularly on income from capital) towards taxing consumption (GST) and to facilitate better alignment of entity and personal tax rates. The latter will have implications for the comparative benefits of the PIE regime.

The Government has indicated that its formal response to these recommendations will be contained in its 2010 Budget, to be delivered in May 2010.

The Government has also indicated a keenness to develop New Zealand as a hub for provision of back office services to the international funds and funds management industry. Again, Budget 2010 Budget is expected to outline more concrete steps to achieve this.

KPMG in New Zealand

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