Tax Working Group Public Submissions Information Release

Release Document

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Submission To Tax Working Group 2018

"…..it is important that we maintain the trust and confidence of all New Zealanders in the integrity of the tax system. In a democracy such as ours, the ability of the Government to raise revenue rests ultimately on the consent and acceptance of all New Zealanders. In order to maintain this acceptance, and fulfil the trust of New Zealanders, we must ensure that the tax system is fair, balanced, and administered well. This is the goal the Group is working towards. Your submissions will help us achieve it." **(Submissions Background Paper, Tax Working Group, 14 March, 2018)**

It is in the spirit of this goal for the Tax Working Group that I am writing to express my deep concern about the inconsistency in the revised foreign investment fund (FIF) rules enacted in 2007 in relation to a long standing tax treaty between New Zealand and the USA that assures no individual person reporting world wide income to both tax jurisdictions will be taxed on the same money by both countries.

FIF Tax Is Inequitable

With the passage of the revised FIF rules, all NZ tax residents who held more than $50,000 worth of foreign financial investments in previously exempted grey listed countries, were forced to suddenly change their investment strategy due to a change in taxation strategy. This left them with two choices; Sell (and repatriate your money to NZ where the property market incurred no tax) or hold (and pay FIF tax). New immigrants to NZ had four years to make their decision. Long term immigrants who were already invested prior to the law change had no such grace period in which to consider changes to their investment strategy.

Non American New Zealanders were faced the same choice as their American counterparts, (sell or hold) but <u>they did ***not*** face the same consequence</u> of double taxation that American born NZ tax residents were faced with. Already obliged to pay capital gains tax to the US on any realised gains, American tax residents of New Zealand faced an ***additional*** tax - <u>regardless of the choice they made</u>. If they chose to exit from their foreign investments, the combined capital gains realised from those investments would potentially put them in a higher tax bracket for the year, thereby losing much of their life savings. If they chose to remain invested in foreign companies, they would be required to pay an FIF tax every year ***AND*** pay capital gains tax to the USA whenever shares were sold, based on whatever gains were realised over the entire time that they owned those shares. No other category of New Zealand tax resident bound by FIF law is obliged to pay tax on realised gains as well as on unrealised accrued value. ***The extra burden that this legislation places on American born Kiwis is a clear anomoly in a law whose stated purpose was to remove inconsistencies in the taxation of investments***.

FIF Tax is Unfair

Shortly after the revised FIF rules came into effect on 1 April 2007, the global economic crisis of 2008 led to a catastrophic loss of years worth of growth in mine (and many other's) portfolios. **By 2013 many investors had not even recouped their losses from the financial crisis. BUT, they would be taxed on any 'gain' in the value of their portfolio each year as they approached the**

zero point at which they started, even though their net position remained lower than at the time of the financial crisis.

FIF Tax Encourages Speculative Investment

"Foreign tax, of the same nature as New Zealand income tax, can be used to reduce the NZ tax liability in relation to foreign-sourced income that results in assessable income.... Such foreign tax credits (for foreign tax paid on foreign investment income) can only be used to reduce the income tax payable on your FIF income." (ird #461, May 2016)

<u>US federal income tax paid as a US citizen,</u> in respect of dividend and capital gains income sourced in the US from investment in companies included under the FIF tax regime<u>, can be applied as credit to offset FIF tax owing in NZ for that financial year only</u>.

"Generally these credits are forfeited (lost) if they are not used... You cannot carry forward unused foreign tax credits where you have used the FDR, CV, deemed rate of return or cost methods to calculate FIF income or loss."(ird #461, May 2016)

American New Zealanders who invest long term are disadvantaged as compared to those who speculate short term in a foreign securities market.

- <u>FIF tax is payable on an annual</u> basis and there is no carry over tax credit for US tax paid on income sourced in the US from investment in companies included under the FIF tax regime
- <u>US capital gains tax is not payable until shares are sold</u> and a gain is realised.

If an American born tax resident of NZ is an active trader speculating in foreign financial investments, foreign tax credit is available for US tax paid on financial investment income (dividends and capital gains) that year. That credit can be applied against FIF tax owing that year. Any remaining credit is forfeited.

If however, an American who is a New Zealand tax resident buys and holds foreign investments long term, there will be no US capital gains tax paid in the year that can be applied as credit against FIF tax owing to NZ for that year. The only available credit that can be applied against FIF owing will be from US tax paid on dividend income. Any residu FIF tax owing must be paid in full by the investor every year. When the investments are eventually sold, the investor must also pay US capital gains tax <u>on gains that have accrued *over the lifetime of each investment*</u>.

In this way FIF encourages short term speculative behaviour in foreign investments and discourages more conservative buy and hold investment.

FIF Tax Is Inconsistent With International Standard Means Of Calculating "Income".

Capital gain is not considered taxable "income" under NZ FIF legislation. Accrued value is not considered taxable "income" under US tax law. As a layperson this is confusing and complicated.

FIF Tax Is Arbitrary And Unpredictable In Its Execution Based On Variable Prices And Exchange Rate Fluctuations
Between March 31, 2015 and March 31, 2016, the value of my shares on the US stock market rose by USD $7,571. I neither bought nor sold any shares during that time. ***No gain was realized and no currency conversion was ever made between USD and NZD.*** However, because the exchange rate for the USD on March 31, 2015 happened to be.7470 and on March 31, 2016 it was .6909 my *unrealized* capital gain in NZD (Using the CV method) would be arbitrarily calculated at $60,447NZD!

Using the FDR method, 5% of my opening value in NZD was $30,474NZD. Although the only *actual* income I made in the 2015/16 tax year (NZ Superannuation plus interest and dividends) was less than the FDR, I was required by FIF legislation to pay tax on an additional $30,474NZD "income" - ***that I never actually realized*** – *and* this put me in a higher tax bracket.

WHAT I AM PROPOSING
In honour of the tax treaty between NZ and USA, and in fairness to American citizens who have made New Zealand their home, I propose the introduction of a grandfather clause to the 2007 FIF amended legislation granting a retrospective exemption to US citizens who were NZ tax residents prior to the amendment coming into effect, and who were already invested in companies located in (then) tax exempt grey listed countries. The exemption that I propose would stand only for those investments already held in previously tax exempt grey listed countries prior to the legislation coming into effect in 2007. Any equities purchased after the 2007 amendment came into effect would be subject to FIF obligations.

This minor change could take place on any remedial legislation review day. Precedence for making the change retrospective was established in 2006 when IRD exempted holders of Australian Super Funds from FIF obligations and backdated the exemption to 1993-94. No such consideration was given to how this law change would affect NZ tax residents with US citizenship, all of whom are already obliged to pay US tax when capital gains are realised.

Sincerely,
Kathy Torpie