AN OVERVIEW OF HOW THE NEW OFFSHORE INVESTMENT TAX RULES APPLY TO INDIVIDUALS AND FAMILY TRUSTS

New tax rules applying to less than 10 percent shareholdings in foreign companies have recently been enacted. For people who have a standard income year (the large majority), the new rules apply from the start of their 2007–08 income year on 1 April 2007.

Do the new rules apply to you?

Investments in Australian-resident and listed companies are generally exempt from the new rules. These investments will continue to be taxable as they are currently. This means for most people, who hold their shares on capital account, they are taxable only on dividends. Generally, you will be entitled to this exemption if you receive a dividend carrying Australian franking credits from a company listed on the Australian Stock Exchange All Ordinaries index (the 500 largest listed companies).

The new rules also do not apply to you if the total cost of your offshore shares (not counting shares in Australian-resident listed companies) is NZ$50,000 or less. You will continue to pay tax only on dividends if you hold your shares on capital account. It is important to know that this $50,000 rule is a threshold rather than an exemption and does not generally apply to family trusts. Therefore, if the cost of your offshore shares exceeds $50,000 they are all subject to the new rules and not just the excess costing more than $50,000. Other points about this rule are:

- It is the original cost of your shares rather than their current market value that is relevant for this threshold. However, you may choose to treat shares acquired before 2000 as costing half their market value on 1 April 2007.
- The exchange rate on the date of your purchase of any shares in foreign currency should be used.
- The $50,000 threshold takes into account brokerage fees if these are part of the cost of acquiring any shares.
- A couple can qualify for a total NZ$100,000 threshold. This can be achieved by half of the shares costing $100,000 being held in each person’s name, the shares being wholly jointly owned, or a combination of individual and joint ownership (each person would have to add half the cost of their jointly owned shares to their individual shares to find out if they qualify for the threshold).

New fair dividend rate method

If the new rules apply to you, you will be taxed each year under the new fair dividend rate method on a maximum of 5 percent of the opening market value of your offshore shares. If the total gain (dividends and capital gains) on your offshore share portfolio is less than 5 percent then tax is payable on the lower amount with no tax payable if the shares make a loss. Other key features are:

- Dividends are not taxed; however, foreign withholding tax deducted from dividends is still available as a foreign tax credit.
- All your offshore shares that are subject to the new rules are taken into account in determining whether your total gain is less than 5 percent (that is, a pooled approach is taken).
- Generally only shares held at the start of an income year are taken into account and therefore purchases and sales of shares during a year are ignored. However, shares that are bought and sold in the same year are taxed under the new rules.
- No losses are carried over under the new method – each year is treated separately.

Examples

If you make a total return of more than 5 percent

John holds offshore shares that have a market value of $100,000 at the start of the year. These shares are worth $115,000 at the end of the year. John also receives a $10,000 dividend.

Under the fair dividend rate method, John pays tax on 5 percent of $100,000 or a lower amount if his return for the year is less than 5 percent. No tax is payable if his shares make a loss.

John's total return for the year is the $15,000 capital gain on his shares and the dividend of $10,000. His total return is therefore $25,000. However, his taxable income for the year is limited to 5 percent of the opening value of his shares. This would result in taxable income of $5,000.

If you make a total return of less than 5 percent

Mary also holds offshore shares that have a market value of $100,000 at the start of the year. These shares increase in value to $102,000 at the end of the year. Mary also receives a $1,000 dividend.

Mary would pay tax on 5 percent of $100,000 (her opening value) unless she can show that she made a return of less than this.

Mary's total return for the year is $3,000 (comprising a capital gain of $2,000 and a dividend of $1,000), which is less than 5 percent of her opening value of $100,000. Therefore, Mary is only taxed on $3,000.

If you make a loss

Judy holds offshore shares that have a market value of $100,000 at the start of the year, which decrease in value to $75,000 at the end of the year. She also receives a $10,000 dividend.

Judy would be taxable on 5 percent of the opening value of her shares unless she can show that her total return for the year is less than 5 percent.

Judy's total return for the year comprises a capital loss of $25,000 and the dividend of $10,000. Her net return is therefore a loss of $15,000. Because Judy has made a loss on her offshore shares, no tax is payable.