Income tax - foreign tax credits - how to calculate a foreign tax credit

PUB 00370

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Dear Grant and Kim

PUB 00370: Income tax – foreign tax credits – how to calculate a foreign tax credit

Thank you for the opportunity to comment on the draft interpretation statement (the statement).

The statement provides guidance on how to calculate a foreign tax credit under subpart LJ of the Income Tax Act 2007.

We commend you for a comprehensive statement that is well written, understandable and easy to follow. The flowcharts and the numerous practical examples will be valuable in helping taxpayers and agents understand the concepts.

We set out some suggestions that we think would add value or clarify the statement.

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Part 1: How to calculate a foreign tax credit

Step 1: Establish the person's tax position

Another example illustrating how a person's income tax liability and possibly foreign tax credit is affected when their net profit is reduced by losses carried forward would be helpful. Taxpayers' do not always appreciate carried forward losses must be utilised before their foreign tax credit is calculated.

Group tax losses

In our view it would be useful if the commentary included a discussion on how a company's ability to claim a foreign tax credit is affected when a company receives a loss offset from a group company.

Foreign income tax refunds

On page 23, the last sentence of example 10, states:

> *Isaac will need to contact the Australian Taxation Office if he wants a refund of the $2,000 incorrectly withheld.*

This raises the question: in what circumstances , if any, should the recipient first approach the withholding party for a refund of the incorrectly withheld tax? This point may need to be considered further.

Foreign income and foreign tax to be converted to New Zealand dollars

Paragraph 53 states that amounts must be converted using;

> - *The close of trading spot exchange rate (s YF 1(2));*
> - *monthly average rates if the Commissioner or a provision in the Act allows it (s YF 1(3); or*
> - *rates or methods approved by the Commissioner.*

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It would be instructive if the statement could confirm whether the Commissioner allows the use of monthly average rates to convert a foreign tax credit, or whether there is a provision in the Act that actually allows a foreign tax credit to be converted using monthly average rates. It would also be helpful if the Statement could confirm whether there have been any rates or methods approved by the Commissioner to convert a foreign tax credit.

Part 3 Specific Scenarios

Each FIF attributing interest is a separate segment

It would be beneficial if paragraph 98 included an explanation of why the Commissioner considers each FIF attributing interest is a separate segment of foreign-sourced income.

Example 12: FIF rules

Can Co 2

The first sentence of the final paragraph on page 37 we recommend inserting the words "therefore is a non-ordinary share" after "Can Co 2 is not listed on a recognised stock exchange".

In our experience, it is often not easy to obtain market values for stocks not listed on the stock exchange or frequently traded. To obtain the market values, a taxpayer will generally have to incur significant fees. Consequently, the comparative value method may not be used frequently to calculate the FIF income or loss for non-ordinary shares. The valuation costs counteract the use of this method.

FDR example

We recommend a further example be included illustrating an FDR calculation for a portfolio interest

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where the taxpayer holds more than one FIF.

Attribution

Readability of paragraph 101 could be improved by footnoting the references to Tax Information Bulletin Vol 31, No 5 (June 2019):23; and Tax Information Bulletin Vol 33, No 4 (May 2021):8 rather than including in the body of the paragraph.

Financial arrangement income

In our view, financial arrangement income is a specific scenario (just like foreign investment funds) that warrants a separate section. Where relevant you could refer the reader to other parts of the statement.

The section should explicitly explain:

- accrual basis taxpayers and the timing mismatches that can occur when claiming a foreign tax credit;
- how financial arrangement income may include a foreign exchange loss and how this affects a foreign tax credit .

Editorial

Included below is a list of recommended editorial changes:

- Page 6, flowchart item D, second line, after NZ tax payable, delete “per”;
- Page 38 example 12, replace “an” with “a”. As such, Walter has a FIF loss from Can Co 2 of $20,000.

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We are happy to discuss our submission. Please contact Teri Welham in this regard.

Yours sincerely

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