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DISCLAIMER

All discussions today are general in nature and not to be taken as financial advice. The views and opinions of the speakers are his/her own and may not necessarily represent the views or opinion of Kernel Wealth Limited.

This is not tax advice, independent expert tax advice should be received before making any decision.

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Tax drag on international investments

Kernel produced a ‘Guide to Taxation of Foreign Equities for New Zealand Residents’ in partnership with MyFiduciary and Johnstone Associates.

Key conclusions are:

- Tax structure matters a lot. For an investor on a 33% marginal tax rate investing in international equities, tax will reduce your long-term return by between 1.2% and 2.6% depending on how you invest. For Australian equities, the tax drag ranges from 0.8% to 2.3% per annum.

- For most larger investors in most years, 1.40% total tax cost p.a. on international shares through a NZ unlisted fund is the best outcome and many common products / structure cause significantly more tax.

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NZ Equities

Think about your investor

Main tax item to consider – PIR vs RWT

	Through multi rate PIE fund at 28% PIR			Direct investment at 33% marginal tax rate		
Imputation	**0%**	**70%**	**100%**	**0%**	**70%**	**100%**
Invested	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Net dividend	3%	3%	3%	3%	3%	3%
Gross dividend	$300.00	$373.13	$416.67	$300.00	$373.13	$416.67
Dividend received	$300.00	$300.00	$300.00	$300.00	$300.00	$300.00
Tax payable	$84.00	$104.48	$116.67	$99.00	$123.13	$137.50
Imputation credits	$0.00	-$73.13	-$116.67	$0.00	-$73.13	-$116.67
Tax to pay	$84.00	$31.34	$0.00	$99.00	$50.00	$20.83
Tax rate	28.0%	8.4%	0.0%	33.0%	13.4%	5.0%
As % investment	0.84%	0.31%	0.00%	0.99%	0.50%	0.21%

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Difference between Listed PIE vs Multi-Rate PIE

	Transaction Fees	Tax Rates	Spreads	Pricing	Investment style
Index Funds	**ZERO**	0% - 28%	**ZERO**	End of day	Passive
ETFs	0.1% - 0.7%	28%*	~0.1%	Real time	Passive & Active

*NZ Listed ETFs

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How are international investments taxed?

Withholding on Company Dividends → **Withholding on foreign Fund Distributions** → **NZ Tax liability** (offset by either fund distribution withholding or dividend withholding but never both)

In addition, the tax due in New Zealand as a resident under the PIE rules, FIF rules, or as a direct dividend depending on personal tax circumstances.

Two core calculation methods for FIF:

- **Fair Dividend Rate (FDR)** - FIF income is 5% of the total average value of the investments which is then taxed at the applicable rate.
- **Comparative Value (CV)** – Essentially, capital gains: being Closing value + Gains – Opening value + Purchases. Any loss incurred cannot be claimed.

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Investing in International Shares Direct

Let's start with holding direct: Tax rate, calculations, payments and returns

If you invest in international shares directly you will be taxed at the normal marginal tax rates up to 39%.

If not under de minimis exemption (total investment book value in global shares in all channels and including foreign unit trusts/funds is less than NZD 50k) you will have to undertake the tax calculations yourself, including the FDR and other tax calculations (or use an administration platform or hire an accountant, both of which come at a cost).

Could bring the investor into the provisional tax system.

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When going direct works

	Pros	Cons
Holding direct under $50k cost value	• Only taxed on dividends received at 33%	• FX, foreign custody and brokerage costs to consider • Effort to claim FTCs • No claim to Aus. Franking Credits • Single selection • NZ tax obligations calculated at RWT rates
Holding direct over $50k cost value	• Can calculate using CV method to reduce tax liability to 0.38% (estimate of withholding taxes) if total portfolio losses in financial year, or 33% of unrealised & realised gains. • Full control	• When portfolio returns over 5%, investor would use 5% FDR. Using 33% flat RWT rate = 1.65% (5%*33%) in most years = 15% more tax in last 10 of 14 years • When FDR method used, an adjustment is required for quick sale gains where equities are bought and sold within the income year • Single selection • No claim to Australian Franking Credits • 40% US Estate tax risk on US equities incl. ETFs over USD60,000 value • FX, foreign custody & brokerage
Holding in NZ unlisted PIE	• Max 1.40% liability less tax credits • Paperwork handled, all FTCs claimed and correct tax paid • No need for accountant	• Must use FDR method. No choice for years where return <5% • No claim to Australian Franking Credits

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Investing in International Shares via AUT

Very common to use AUT structures, but they are designed and aligned for Australian legislation and investors.

- NRWT of 15%, claimable as a foreign tax credit for NZ tax liability
- No ability to claim franking credits
- AUTs must pay out all income, from dividends and realised capital gains. Effective capital gains tax for NZ investor.
- Need to know if the AUT is exempt FIF regime

	Pros	Cons
Australian Unit Trust (AUT)	• Wider choice of funds than available in NZ • Larger scale funds also meaning management fee can be lower • Range of NZ tax methods	• Capital gains ultimately taxed as income • Loss of FTC on company dividends
NZ unlisted PIE	• Most tax efficient • Paperwork handled, all FTCs claimed and correct tax paid • No need for accountant	• Careful if just a feeder fund, same issues as AUT • Always FDR

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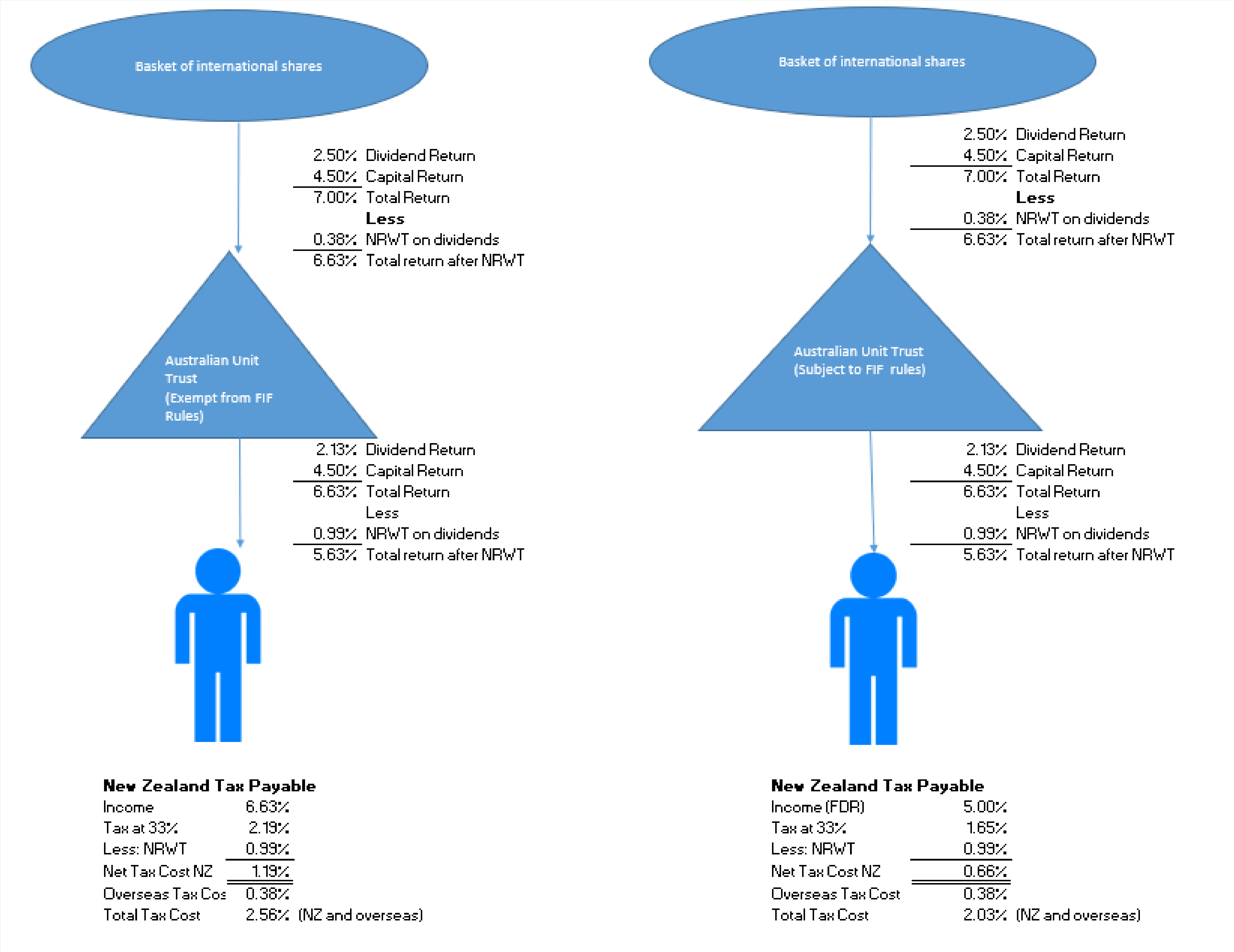
AUT example

For an NZ 33% marginal tax investor, AUT have a total tax cost of 2.03%-2.56% p.a. in an average return year



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Investing in International Shares – all other

International equities via US listed ETF or FIF eligible AUT	Tax opaque. ~0.38% leakage. Can't claim FTC in NZ for NRWT received by intermediary. Normally 15%	15% with W8 otherwise 30% NRWT on distribution received[2]. Can be claimed as 0.32% FTC. **Potential for 40% US Estate taxes on death of individual.**	33% income tax on FIF income less FTC of 0.32%. Choose CV if under 5% TR and FDR if over 5%. Estimated NZ cost of 1.33%.	0.70%-2.03% depending on TR. Expected long term average tax cost 1.52%.
International equities via UCITS ETF	Tax opaque. ~0.38% leakage. Can't claim FTC in NZ for NRWT received by intermediary. Normally 15% NRWT as fund applies for treaty rate.	UCITS design = None	33% income tax on FIF income. Choose CV if under 5% TR and FDR if over 5%.	0.38%-2.03% depending on TR. Expected long term average tax cost 1.49%.
International equities via FIF exempt AUT	Tax opaque. ~0.38% leakage.	All realised capital gains must be distributed (eventually) as income with 15% NRWT.	33% on income of 6.62% (7%-0.38% leakage). Less FTC claimable 0.99%. Estimated NZ tax cost 1.20%	2.56%p.a. in long term
International equities via NZ ETF using intermediate entity	Tax opaque. ~0.38% leakage. 15% treaty rate not claimable as foreign tax credits if investing into foreign funds	None.	28% on FDR 5% deemed dividend. No choice of method.	1.78% net p.a. Paid monthly
International equities via NZ unlisted PIE	15% treaty rate claimable as foreign tax credits. All paperwork by fund and fund administrator.	None.	PIR to max. 28% on FDR 5% deemed dividend. Less FTC of 0.38%. Estimated NZ tax cost 1.02%. Fund does all filing. No choice of method.	1.40%

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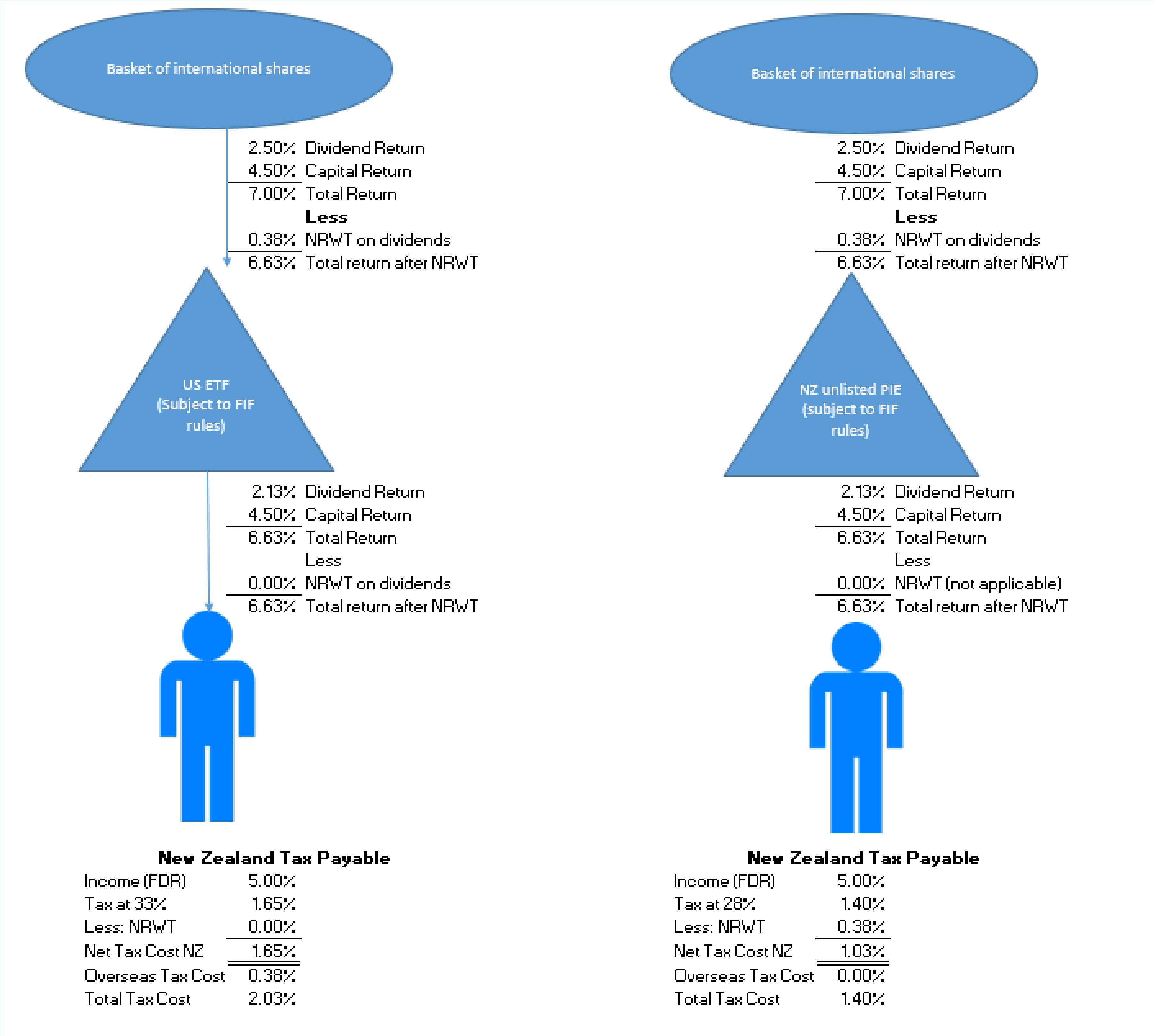
Investing in International Shares – all other



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In Summary

In choosing a fund or product you should always consider:

1. How good is the fund manager?
2. Will the fund likely deliver on the type of investment sought?
3. What is the management fee and also the transaction costs (brokerage/ spreads/loading)?
4. What is the tax structure and expected total tax costs each year?
5. What is the complexity or paperwork burden around tax?

There are trade-offs among all these factors. The key message is that you should focus not just on manager quality and fees, but on fees plus taxes plus transaction costs. Some overseas products come with lower fees but higher taxes, and the net cost will often be higher for most investors.

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Questions?

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