This QWBA concludes that a person cannot claim a foreign tax credit in New Zealand for any amounts withheld by their United Kingdom pension provider from a United Kingdom pension. This confirms Inland Revenue's longstanding view. HM Revenue & Customs agrees with Inland Revenue's view and will refund amounts incorrectly paid to them.

The Commissioner has prepared an operational position *Commissioner's Operational Position on foreign tax credits for amounts withheld from United Kingdom pensions*. This explains how to claim repayments from HMRC, how to stop United Kingdom pension providers making deductions and if necessary how to change past New Zealand tax returns.

QUESTION WE'VE BEEN ASKED QB 14/12

INCOME TAX – Foreign tax credits for amounts withheld from United Kingdom pensions

All legislative references are to the Income Tax Act 2007 (ITA 2007) unless otherwise stated.

This Question We've Been Asked is about ss LJ 2(1) and LJ 3 and articles 19 and 22 of sch 1 to the Double Taxation Relief (United Kingdom) Order 1984 (including the "principal agreement"[1] and the protocols) (the NZ/UK DTA).

Question

1. Can a person claim a foreign tax credit in New Zealand for any amounts withheld in the United Kingdom by their United Kingdom pension provider from their United Kingdom pension payments?

Answer

2. No. A person cannot claim a foreign tax credit in New Zealand for any amounts withheld in the United Kingdom by their United Kingdom pension provider from their United Kingdom pension payments. A person can only claim a foreign tax credit in New Zealand if "foreign income tax" has been paid. An amount withheld from a pension payment in the United Kingdom by a United Kingdom pension provider is not "foreign income tax" for the purposes of New Zealand's tax credit rules. This is because under art 19 of the NZ/UK DTA the United Kingdom has no right to tax pensions paid to New Zealand tax residents.

Explanation

3. We have been asked whether a person can claim a foreign tax credit in New Zealand for amounts withheld in the United Kingdom from their United Kingdom pension payments. This item considers the situation where:

   - A person with a United Kingdom pension has moved to New Zealand and become a tax resident of New Zealand. (The person is a tax resident of New Zealand under New Zealand's domestic residence test (see s YD 1). If the person is a tax resident of both New Zealand and the

[1] Convention between the Government of New Zealand and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, (signed 4 August 1983, entered into force on 1 April 1984 in New Zealand, entered into force in the United Kingdom on 16 March 1984).

United Kingdom, the person may be deemed to be solely a New Zealand tax resident under the tie-breaker tests in art 4(2) of the NZ/UK DTA. For further details on New Zealand's individual residence test and the double tax agreement tie-breaker tests see *IS 14/01 Residence*.)

- The United Kingdom pension payments are taxable in New Zealand.
- The United Kingdom pension provider withholds an amount (in the form of United Kingdom PAYE[2]) from the pension payments because:
  - the person has not filled out the relevant HM Revenue & Customs' form, or
  - the form has not been processed by HM Revenue & Customs and a direction to the pension provider to stop the deductions has not been issued.

4. This item does not consider the situation where:
   - A United Kingdom pension is exempt income under s CW 28, such as a United Kingdom state pension that is paid in accordance with an arrangement under s 70 of the Social Security Act 1964.
   - A lump sum withdrawal is made from a foreign superannuation scheme by a New Zealand resident or a New Zealand resident transfers an interest in a foreign superannuation scheme to a New Zealand (or Australian) superannuation scheme.

Double tax agreements

5. The New Zealand Government enters into double tax agreements with other jurisdictions. A key purpose of these international treaties is to prevent double taxation of income. Once signed, these treaties need to be incorporated into New Zealand law by an Order in Council. This Order in Council incorporates the text of the treaty and any protocols to the treaty into New Zealand law. The NZ/UK DTA is part of New Zealand law by Order in Council: Double Taxation Relief (United Kingdom) Order 1984.

6. One way in which the NZ/UK DTA provides relief from double taxation is to allocate the right to tax certain income to either New Zealand or the United Kingdom. For example, the NZ/UK DTA exempts some types of income from taxation in the country where the income is sourced and allocates the taxing rights to that income to the country of residence of the person deriving the income.

7. There are a number of references to double tax agreements in the ITA 2007. Section BB 3(2) provides that under subpart BH a double tax agreement has effect in relation to income tax. Subpart BH specifically deals with double tax agreements. Section BH 1(4), as relevant, provides that:

> **BH 1 Double tax agreements**
>
> **...**
>
> *Overriding effect*
>
> (4) Despite anything in this Act, except subsection (5), or in any other Inland Revenue Act or the Official Information Act 1982 or the Privacy Act 1993, a double tax agreement has effect in relation to—
>
> (a) income tax:
>
> (b) any other tax imposed by this Act:

[2] In the United Kingdom, pension payers are treated as employers and pensioners are treated as employees, so generally pension payments are subject to PAYE: r 11 of the Income Tax (Pay As You Earn) Regulations 2003 (UK).

...

8. A double tax agreement having "effect in relation to income tax" means that the double tax agreement has an overriding effect as to income tax under the ITA 2007, including the income and tax credit parts of the ITA 2007. Therefore, the income and tax credit parts of the ITA 2007 must always be read together with the relevant articles of a double tax agreement. Where there is any inconsistency between the two, the domestic law must be read subject to the double tax agreement.

9. Article 19(1) of the NZ/UK DTA provides that the sole taxing rights for pensions lie with the country of residence:

> **Article 19 Pensions and annuities**
>
> (1) **Pensions** (including pensions paid under the social security legislation of a Contracting State), and similar remuneration in consideration of past employment or services, **paid to a resident of a Contracting State**, and any annuity paid to a resident of a Contracting State, **shall be taxable only in that State**. [Emphasis added]

10. Article 19(1) provides that a pension paid to a resident of New Zealand shall be taxable only in New Zealand.

11. While art 19 gives New Zealand the sole right to tax the pension income of its residents, it does not require New Zealand to tax such income. For the pension to be taxable in New Zealand, it must also be taxable as income under Part C of the ITA 2007. Some overseas pensions are exempt income in New Zealand and as a result are not taxable in New Zealand: s CW 28.[3] This QWBA assumes that the relevant pension is not exempt income under s CW 28 and is taxable as income in New Zealand. If the pension income is exempt income under s CW 28, then no foreign tax credit will arise. This is because a foreign tax credit can only arise for income that is taxable in New Zealand: ss LJ 2, LJ 4 and LJ 5.

Foreign tax credits

12. If a person's pension income is taxable in New Zealand, the question arises whether any foreign tax credits result for any amounts withheld in the United Kingdom from the pension payments. A foreign tax credit recognises tax that has been paid on that income in another country. A foreign tax credit can reduce the amount of tax payable on that income in New Zealand.

13. A person must have paid "foreign income tax" to be entitled to a foreign tax credit: s LJ 2(1). "Foreign income tax" is specifically defined in s LJ 3 for the purposes of the tax credit rules as "an amount of income tax of a foreign country". In the first instance, the amounts withheld by the United Kingdom pension providers in the United Kingdom appear to be United Kingdom income tax (in the form of PAYE), so appear to be "an amount of income tax of a foreign country" under s LJ 3.

14. However, as noted above, pursuant to s BH 1(4), the NZ/UK DTA has an overriding effect on the tax credit provisions in the ITA 2007. This means that the definition of "foreign income tax" in s LJ 3 (which is used only for the purposes of the tax credit rules) must be read together with the NZ/UK DTA. Where there is any inconsistency between the two, New Zealand's domestic law must be read subject to the NZ/UK DTA. Specifically, the term "foreign income tax" in s LJ 3 must be read subject to the relevant articles in the NZ/UK DTA. This approach is consistent with principles of international treaty interpretation.

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[3] In some circumstances, a United Kingdom state pension will be exempt income under s CW 28 in New Zealand. For example, a United Kingdom state pension that is paid by the special banking method under s 70 of the Social Security Act 1964 is exempt income under s CW 28(1)(e).

15. In determining the overriding effect of the NZ/UK DTA on the tax credit provisions, the Commissioner considers that the NZ/UK DTA must be interpreted in accordance with the text of the relevant articles within the context of the NZ/UK DTA and in light of its purpose. This is because the NZ/UK DTA is an international treaty entered into by New Zealand and it must be interpreted accordingly. New Zealand is a signatory to the Vienna Convention[4] so New Zealand's treaties have to be interpreted according to that convention. Article 31(1) of the Vienna Convention provides that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".

16. Article 2(1)(a) of the NZ/UK DTA lists United Kingdom income tax (which includes United Kingdom PAYE) as a tax covered by the DTA. However, art 19 provides that only New Zealand has the right to tax pension income paid to a New Zealand resident. Therefore, withholding any amounts in the United Kingdom from pension payments is not in accordance with art 19 of the DTA. As a result, the Commissioner considers that any amounts withheld in the United Kingdom from pension payments paid to a New Zealand resident are not "foreign income tax" under s LJ 3 for the purposes of the tax credit rules. As the amounts are not "foreign income tax" under s LJ 3, no foreign tax credit can arise for such amounts under s LJ 2.

Article 22

17. It might be thought that the NZ/UK DTA article dealing with foreign tax credits for the elimination of double taxation (art 22) would be relevant to this issue. However, the Commissioner does not consider that art 22 gives rise to any credit entitlements in circumstances where the NZ/UK DTA allocates sole taxing rights for certain types of income, such as in the present case.

18. Article 22 deals with the elimination of double taxation. The article sets out the agreement between New Zealand and the United Kingdom as to when New Zealand and the United Kingdom will give foreign tax credits. Article 22(2)(a) sets out the circumstances in which New Zealand agrees United Kingdom tax paid will be allowed as a credit against New Zealand tax payable on the same income. It provides:

> **Subject to the provisions of the law of New Zealand** from time to time in force relating to the allowance as a credit against New Zealand tax of tax paid in any country other than New Zealand (**which shall not affect the general principle hereof**), **United Kingdom tax** computed by reference to income from sources in the United Kingdom and **paid under the law of the United Kingdom and in accordance with this Convention**, whether directly or by deduction, in respect of income derived by a resident of New Zealand from sources in the United Kingdom (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid), **shall be allowed as a credit against the New Zealand tax** computed by reference to the same income and payable in respect of that income. [Emphasis added]

19. In other words, art 22(2)(a) provides that:

- A foreign tax credit is allowed against New Zealand tax for United Kingdom tax paid on the same income.
- The allowance of the foreign tax credit is subject to New Zealand's domestic laws (that is, as to the timing and the amount of the credit). New Zealand's domestic law must be interpreted so as to uphold the general principle that a foreign tax credit should be available to eliminate double taxation.

[4] Vienna Convention on the Law of Treaties 1155 UNTS 331 (opened for signature 23 May 1969, ratified by New Zealand on 4 August 1971).

- Any foreign tax credit allowed under art 22 must be for United Kingdom tax that is paid not only under the law of the United Kingdom but also in accordance with the NZ/UK DTA.

20. As noted above, the articles in the NZ/UK DTA must be interpreted in their context and in light of the object and purpose of the NZ/UK DTA. Article 22(2)(a) expressly states that relief from double taxation only arises when United Kingdom tax is paid "in accordance with this Convention" (which includes art 19). Under art 22, therefore, a foreign tax credit will only arise when the tax is paid in accordance with the other NZ/UK DTA articles. No tax is payable in the United Kingdom as New Zealand has the sole taxing rights (art 19). Therefore art 22 does not give rise to any credit entitlements. This is because under the NZ/UK DTA, as it applies to pensions, there is no double taxation to eliminate because New Zealand has been given the sole taxing rights for United Kingdom pensions paid to New Zealand residents.

21. More generally, in circumstances where New Zealand has agreed to share the taxing rights for a type of income (ie, where New Zealand does not have sole taxing rights to the income) under an article in the NZ/UK DTA then art 22 applies to provide relief from double taxation of New Zealand residents. Under art 22 New Zealand generally agrees to give a tax credit against New Zealand tax payable to the extent that the United Kingdom is entitled by an article in the NZ/UK DTA to tax that same income. If amounts are deducted in excess of what has been agreed under the NZ/UK DTA, New Zealand is not required to provide a tax credit for that excess. This is because any tax paid in the United Kingdom in excess of the level agreed in the NZ/UK DTA is not "foreign income tax" for New Zealand tax credit purposes.

Other arguments

22. The Commissioner is aware of possible counter-arguments that suggest a foreign tax credit might arise in these circumstances. However, the Commissioner considers that these arguments are not consistent with the overriding effect of the NZ/UK DTA under s BH 1(4), New Zealand's domestic tax credit rules and international practice.

23. As noted above, the Commissioner acknowledges that an amount withheld from a pension payment by a United Kingdom pension provider may appear, on the face of it, to be "foreign income tax". This is because there appears to be an obligation on the United Kingdom pension providers to withhold PAYE from the pensions of United Kingdom residents and the PAYE deducted is then paid to HM Revenue & Customs. However, as discussed above, the deductions are not "foreign income tax" in New Zealand for the purposes of the New Zealand tax credit rules because the tax deducted is not tax imposed in accordance with the NZ/UK DTA, and the NZ/UK DTA has an overriding effect in relation to New Zealand's domestic legislation. HM Revenue & Customs accepts that they have no right to tax United Kingdom pension income paid to New Zealand residents. To observe their agreement under art 19 of the NZ/UK DTA HM Revenue & Customs provides a domestic system for New Zealand residents to notify their United Kingdom pension providers that they are no longer United Kingdom residents and to claim repayments of PAYE deducted for periods before their change of residency notification has been processed.

24. Further, it has been suggested that the above approach results in the NZ/UK DTA removing a foreign tax credit that is available under domestic law. Such a result would appear to be inconsistent with the role of double tax agreements only to relieve double taxation and not to remove benefits provided to a taxpayer under domestic law. However, as the NZ/UK DTA has allocated the sole taxing right to New Zealand in these circumstances, the NZ/UK DTA has not denied a foreign tax

credit available under domestic law. Instead, the NZ/UK DTA has determined that the income can only be taxable in New Zealand. The allocation of taxing rights is another way, different from the provision of tax credits, for double tax agreements to provide relief from double taxation. This is explained in the commentary to Arts 23A and 23B of the OECD model treaty ("Commentary on Articles 23 A and 23 B - Concerning the methods for elimination of double taxation ", in OECD, *Model Tax Convention on Income and on Capital 2010 (Full Version)*, OECD Publishing).

25. It has also been suggested that art 22 allows a foreign tax credit for any tax covered by art 2 of the DTA. However, the Commissioner considers that this argument does not take into account the fact that art 22 must be read in light of the other articles of the DTA — in this case art 19. Under art 19, pensions paid from the United Kingdom to New Zealand residents are only taxable in New Zealand. Consequently, art 22 does not give rise to any credit entitlements.

26. The Commissioner is aware of an argument that the existence of s LJ 7 suggests that a foreign tax credit is available. Section LJ 7 deals with the situation where a person has paid foreign income tax and is entitled to a tax credit but receives a refund. Essentially, it requires that the refund be taken into account in the calculation of the credit (if the credit has yet to be determined) or that the lesser of the refund amount and the foreign tax credit amount be paid to the Commissioner (if the credit has already been claimed). It has been suggested that this provision is available to taxpayers in the circumstances of this item ie, where an amount has been paid to a foreign tax authority on certain income where that authority does not have the taxing rights to that income. Further, it is suggested that the existence of s LJ 7 shows that a credit is available up to the time a refund is provided.

27. The Commissioner considers this argument is not consistent with the overriding effect of s BH 1(4). Section LJ 7 only applies to refunds of "foreign income tax". As explained above, the amounts withheld from United Kingdom pension payments in the circumstances of this item do not satisfy that definition. In addition, the statutory history of s LJ 7 supports the conclusion that it was not intended to apply to such amounts. Further, New Zealand and the United Kingdom have entered into the NZ/UK DTA, which specifies the taxation rights in relation to pension payments between the two states. As a result, the context suggests that any foreign tax credit should be determined by the terms of the NZ/UK DTA. Section LJ 7 applies where the foreign tax authority has the taxing rights over the income but subsequent adjustments are made to the calculation of that foreign income tax resulting in a refund to the taxpayer.

28. Finally, the Commissioner is also aware of an argument that s LJ 1(5) operates to allow a foreign tax credit under s LJ 2 for an amount that is contrary to the NZ/UK DTA. Section LJ 1(5) deems s BH 1 (and other sections) to apply as far as applicable, and modified as necessary, for the purposes of s LJ 2, as if that section were a double tax agreement. The original purpose of the predecessor to s LJ 1(5), when the unilateral and bilateral credit rules were in distinct and separate parts of the predecessors of the ITA 2007, was to ensure that unilateral foreign tax credits were subject to the same rules as bilateral foreign tax credits. Following the consolidation of the provisions in the ITA 2007 unilateral and bilateral foreign tax credits are dealt with together and are subject to the same rules. This suggests that the original purpose for s LJ 1(5) no longer exists. However, even if s LJ 1(5) is able to be given an interpretation based on the plain meaning of its words, s LJ 1(5) itself would still need to be read together with the NZ/UK DTA. The Commissioner considers that allowing a foreign tax credit under subpart LJ would be inconsistent with s BH 1(4) and would undermine the taxing rights allocated under the NZ/UK DTA.

Summary

29. In summary, a person is not entitled to a foreign tax credit for the amounts withheld in the United Kingdom from a United Kingdom pension because the amounts are not "foreign income tax" under s LJ 3 for the purposes of the tax credit rules. The Commissioner considers that where a NZ/UK DTA applies the definition of "foreign income tax" must be read together with the articles of the NZ/UK DTA. This means "foreign income tax" is a tax that is covered by the NZ/UK DTA and paid in accordance with the articles of the NZ/UK DTA. The amounts withheld in the United Kingdom are not "foreign income tax" because under art 19 of the NZ/UK DTA the United Kingdom has no right to tax pensions paid to New Zealand residents. New Zealand has not agreed under art 22 to allow a foreign tax credit for any United Kingdom tax deducted from the pensions.

References

Subject references
Double tax agreements
Foreign tax credits
Pensions

Legislative references
Sections BB 3(2), BH 1, CW 28, LJ 1(5), LJ 2(1), LJ 3, LJ 4, LJ 5, and LJ 7 and of the Income Tax Act 2007
Articles 2(1)(a), 19 and 22 of sch 1 of the Double Taxation Relief (United Kingdom) Order 1984
Article 31(1) of the Vienna Convention

Other references
Commentary on Articles 23 A and 23 B - Concerning the methods for elimination of double taxation ", in OECD, Model Tax Convention on Income and on Capital 2010 (Full Version)

APPENDIX – LEGISLATION

Income Tax Act 2007

30. Section BB 3(2) provides:

BB 3 Overriding effect of certain matters

…

Double tax agreements: subpart BH

(2) Under subpart BH (Double tax agreements) a double tax agreement has effect in relation to—

(a) income tax; or

(b) any other tax imposed by this Act; or

(c) the exchange of information that relates to a tax, as defined in paragraphs (a)(i) to (v) of the definition of **tax** in section 3 of the Tax Administration Act 1994.

31. Section BH 1 provides:

BH 1 Double tax agreements

Meaning

(1) Double tax agreement means an agreement that—

(a) has been negotiated for 1 or more of the purposes set out in subsection (2); and

(b) has been agreed between—

(i) the government of any territory outside New Zealand and the government of New Zealand; or

(ii) the Taipei Economic and Cultural Office in New Zealand and the New Zealand Commerce and Industry Office; and

(c) has entered into force as a result of a declaration by the Governor-General by Order in Council under subsection (3).

Purposes

(2) The following are the purposes for which a double tax agreement may be negotiated:

(a) to provide relief from double taxation:

(b) to provide relief from tax:

(c) to tax the income derived by non-residents from any source in New Zealand:

(d) to determine the income to be attributed to non-residents or their agencies, branches, or establishments in New Zealand:

(e) to determine the income to be attributed to New Zealand residents who have special relationships with non-residents:

(f) to prevent fiscal evasion:

(g) to facilitate the exchange of information:

(h) to assist in recovering unpaid tax.

Entry into force

(3) An agreement to which subsection (1)(a) and (b) apply enters into force on the date specified by the Governor-General by Order in Council.

Overriding effect

(4) Despite anything in this Act, except subsection (5) or (5B), or in any other Inland Revenue Act or the Official Information Act 1982 or the Privacy Act 1993, a double tax agreement has effect in relation to—

(a) income tax:

(b) any other tax imposed by this Act:

(c) the exchange of information that relates to a tax, as defined in paragraphs (a)(i) to (v) of the definition of tax in section 3 of the Tax Administration Act 1994.

Agreement for recovery of tax

(5) An agreement that provides for the recovery of unpaid tax is subject to Part 10A of the Tax Administration Act 1994.

Foreign account information-sharing agreements

(5B) A foreign account information-sharing agreement is subject to Part 11B of the Tax Administration Act 1994.

Reference to profits

(6) A reference in a double tax agreement to the profits of an activity or business is to be read, if possible, as a reference to the amount that would be a person's net income if that activity or business were their only activity or business.

Reference to unrelated persons

(7) A reference in a double tax agreement to 2 persons being unrelated is to be read, if possible, as a reference to 2 persons being not associated

32. Section CW 28 provides:

CW 28 Pensions

Exempt income

(1) The following are exempt income:

(a) a pension or allowance under the War Pensions Act 1954, other than a veteran's pension:

(b) a pension or allowance of any other kind granted in New Zealand or overseas by any government relating to any war or to disability attributable to or aggravated by service in the armed forces or the police:

(c) a payment of portable New Zealand superannuation:

(d) a payment of portable veteran's pension:

(e) an overseas pension.

Meaning of overseas pension

(2) In this section, **overseas pension** means—

(a) an overseas pension, to the extent of sums subtracted under section 70 of the Social Security Act 1964, by the department currently responsible for administering that Act, from—

(i) a monetary benefit paid under that Act; or

(ii) a monetary benefit, other than New Zealand superannuation or a veteran's pension, paid under the Social Welfare (Reciprocity Agreements, and New Zealand Artificial Limb Service) Act 1990:

(b) an overseas pension to the extent to which it is subject to an arrangement under section 70(3) of the Social Security Act 1964.

33. Section LJ 1(5) provides:

LJ 1 What this subpart does

...

Double tax agreements

(5) This subpart and sections BH 1 (Double tax agreements) and CD 19(1) (Foreign tax credits and refunds linked to dividends) and section 88 of the Tax Administration Act 1994 as far as they are applicable, and modified as necessary, apply for the purposes of section LJ 2, as if that section were a double tax agreement.

34. Section LJ 2(1) and (2) provides:

LJ 2 Tax credits for foreign income tax

Amount of credit

(1) A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income, determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

...

35. Section LJ 3 provides:

LJ 3 Meaning of foreign income tax

For the purposes of this Part, foreign income tax means an amount of income tax of a foreign country.

36. Section LJ 4 provides:

LJ 4 Meaning of segment of foreign-sourced income

For the purposes of this Part, a person has a segment of foreign-sourced income equal to an amount of assessable income derived from 1 foreign country that comes from 1 source or is of 1 nature.

37. Section LJ 5 provides:

LJ 5 Calculation of New Zealand tax

What this section does

(1) This section provides the rules that a person must use to calculate the amount of New Zealand tax for an income year in relation to each segment of foreign-sourced income of the person that is allocated to the income year.

Calculation for single segment

(2) If the person has a notional income tax liability of more than zero, the amount of New Zealand tax for the income year relating to the allocated segment is calculated using the following formula, the result of which cannot be less than zero:

(segment – person's deductions/ person's net income) * notional liability

Definition of items in formula

(3) In the formula in subsection (2),—

(a) **segment** is the amount of the segment of foreign-sourced income for the income year:

(b) **person's deductions** is the amount of the person's deduction for the tax year corresponding to the income year that is attributable to the segment of foreign-sourced income:

(c) **person's net income** is the person's net income for the tax year corresponding to the income year under section BD 4(1) to (3) (Net income and net loss):

(d) **notional liability** is the person's notional income tax liability for the income year under subsection (5).

When subsection (4B) applies

(4) Subsection (4B) applies for the income year when the total amount of New Zealand tax for all segments of foreign-sourced income of the person calculated under subsection (2) is more than the notional income tax liability

Modification to results of formula for single segment

(4B) Each amount of New Zealand tax calculated under subsection (2) in relation to each segment of foreign-sourced income is adjusted by multiplying the amount by the following ratio:

person's notional income tax liability/ NZ tax

Definition of item in formula

(4C) In the formula in subsection (4B), NZ tax is the amount given by adding together the result of the calculation under subsection (2), for each segment of assessable income from all sources, including assessable income sourced in New Zealand.

Person's notional income tax liability

(5) For the purposes of this section, a person's notional income tax liability for a tax year is calculated using the formula—

(person’s net income – losses) * tax rate

Definition of items in formula

(6) In the formula in subsection (5),—

(a) **person’s net income** is the person’s net income for the tax year:

(b) **losses**—

(i) is the amount of the loss balance carried forward to the tax year that the person must subtract from their net income under section IA 4(1)(a) (Using loss balances carried forward to tax year):

(ii) must be no more than the amount of the person's net income:](c)tax rate is the basic rate of income tax set out in schedule 1, part A (Basic tax rates: income tax, ESCT, RSCT, RWT, and attributed fringe benefits).

(c) **tax rate** is the basic rate of income tax set out in schedule 1, part A (Basic tax rates: income tax, ESCT, RSCT, RWT, and attributed fringe benefits

38. Section LJ 7 provides:

LJ 7 Repaid foreign tax: effect on income tax liability

Who this section applies to

(1) This section applies to a person who has—

(a) paid an amount of foreign income tax, or in relation to whom an amount of foreign income tax has been paid, on a segment of foreign-sourced income in relation to which they are entitled to a tax credit under section LJ 2; and

(b) received a refund, amount, or benefit (the refund) determined directly or indirectly by reference to some or all of the payment of foreign income tax.

When refund received before assessment

(2) If the person receives the refund before they assess their income tax liability for a tax year, the amount of the tax credit for the foreign income tax paid is reduced by the lesser of—

(a) the amount of the refund:

(b) the amount of New Zealand tax payable on the foreign-sourced income calculated under section LJ 5.

When refund received after assessment

(3) If the person receives the refund after they have assessed their income tax liability for a tax year, have used an amount of foreign tax credit in satisfying that liability, and have not taken the refund into account in that assessment, the person is liable to pay the Commissioner the lesser of—

(a) the amount of the refund:

(b) the amount of New Zealand tax payable on [[the foreign-sourced income]] calculated under section LJ 5.

Date for payment

(4) In subsection (3), the date for payment is 30 days after the later of—

(a) the date on which the person receives the refund:

(b) the date of the notice of assessment in relation to which the person has used the credit.

Associated persons

(5) For the purposes of this section, the refund is treated as received by the person, whether it is received by the person, a person who paid the foreign income tax, or a person associated with either of them.

Double Taxation Relief (United Kingdom) Order 1984, Schedule 1

39. Article 2(1)(a) provides:

Article 2 Taxes covered

(1) The taxes which are the subject of this Convention are:

(a) in the United Kingdom:

(i) the income tax;

(ii) the corporation tax;

(iii) the capital gains tax; and

(iv) the petroleum revenue tax;

(hereinafter referred to as "United Kingdom tax");

…

40. Article 19 provides:

Article 19 Pensions and annuities

(1) Pensions (including pensions paid under the social security legislation of a Contracting State), and similar remuneration in consideration of past employment or services, paid to a resident of a Contracting State, and any annuity paid to a resident of a Contracting State, shall be taxable only in that State.

(2) The term "annuity" means a stated sum payable periodically at stated times during life or during a specified or ascertainable period of time under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

41. Article 22 provides:

Article 22 Elimination of double taxation

(1) Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory outside the United Kingdom (which shall not affect the general principle hereof):

(a) New Zealand tax payable under the law of New Zealand and in accordance with this Convention whether directly or by deduction, on profits, income or chargeable gains from sources within New Zealand (excluding, in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against any United Kingdom tax computed by reference to the same profits, income or chargeable gains by reference to which the New Zealand tax is computed.

(b) In the case of a dividend paid by a company which is a resident of New Zealand to a company which is a resident of the United Kingdom and which controls directly or indirectly at least 10 percent of the voting power in the company paying the dividend, the credit shall take into account (in addition to any New Zealand tax for which credit may be allowed under the provisions of subparagraph (a) of this paragraph) the New Zealand tax payable by the company in respect of the profits out of which such dividend is paid.

(2) (a) Subject to the provisions of the law of New Zealand from time to time in force relating to the allowance as a credit against New Zealand tax of tax paid in any country other than New Zealand (which shall not affect the general principle hereof), United Kingdom tax computed by reference to income from sources in the United Kingdom and paid under the law of the United Kingdom and in accordance with this Convention, whether directly or by deduction, in respect of income derived by a resident of New Zealand from sources in the United Kingdom (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid), shall be allowed as a credit against the New Zealand tax computed by reference to the same income and payable in respect of that income.

(b) In the event that the Government of New Zealand should impose tax on dividends received by companies which are resident in New Zealand the Contracting States will enter into negotiations in order to establish new provisions concerning the taxation of such dividends derived from sources in the United Kingdom.

(3) For the purposes of paragraphs (1) and (2) of this Article, profits, income and capital gains derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Convention shall be deemed to arise from sources in that other State.

(4) Where, under the provisions of Article 10, profits on which an enterprise of a Contracting State has been charged to tax in that State are also included in the profits of an enterprise of the other Contracting State and the profits so included are profits which would have accrued to that enterprise of the other State if the conditions made or imposed between the two enterprises in their commercial or financial relations had been those which would have been made or imposed between independent enterprises, the

amount included in the profits of both enterprises shall be treated for the purpose of this Article as income from a source in the other State of the enterprise of the first-mentioned State and relief shall be given accordingly under the provisions of paragraph (1) or paragraph (2) of this Article.

(5) Nothing in this Article shall entitle a person who is a resident of a Contracting State to credit against tax of that Contracting State of tax of the other Contracting State if the terms of the transactions giving rise to the profits on which the tax of the other State is payable are not such as might be expected in a bona fide commercial transaction and if they have as their main object, or one of their main objects, the obtaining of that credit.