BUSINESS

Warning to small-time foreign share investors as man loses a third of his investment in tax

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Do it yourself investors are being warning about the tax risks of foreign investment. Photo/123RF.

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A tax expert has sounded a warning to small investors in overseas shares after a man lost a third of his investment when a US-based exchange traded fund went into liquidation and he had to pay tax on the money it gave back to him.

Aucklander Simon Landers invested $6000 in March last year via ASB Securities into an exchange traded fund (ETF) which tracked an index of companies involved in virtual reality and augmented reality.

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But he was shocked to find his investment money returned to him last month - and then to see $2000 debited from his trading account by ASB Securities to pay resident withholding tax.

"I found out a week ago by looking at my bank account."

Landers said he then found the fund was liquidated at the end of December and money was returned to investors.

"My shares were up 1 per cent but because ASB took 33 per cent I lost money."

He said there had been virtually no gain in the value of his investment, yet he had been penalised by a hefty tax bill.

Simon Landers lost a third of his investment to tax after the overseas-based exchange traded fund he had invested in was liquidated. Photo/Supplied.

An ASB spokeswoman said the ETF was run by US-based fund manager Defiance and on November 29 its board decided to close and liquidate the fund as of December 27.

"The liquidation and closure of the fund was proposed after consideration of the fund's prospects for growth, among other factors."

Landers said he was upset that ASB had not told him the ETF was being liquidated because if he had known that he could have sold his shares in the fund.

"I had no idea what was going on. I had no idea the ETF had been liquidated."

The ASB spokeswoman said it was the bank's policy not to communicate with customers about mandatory corporate events - where the shareholder has no option, or ability to specify a desired action to be taken in relation to their shareholding within the corporate action. It only told shareholders about voluntary corporate actions where the shareholder does have options within the corporate action.

She said the proceeds from the ETF's closure were classified as a dividend for New Zealand tax purposes, so it was necessary to tax the full amount at the resident withholding tax rate of 33 per cent.

Landers said he was also upset because ASB took the tax money out of his account without asking permission first.

The ASB spokeswoman said the ASB Securities terms and conditions permitted it to withhold tax from any dividend payable to a client.

"This is ASB Securities' standard practice."

A spokeswoman for ASB Securities said tax law required it to take withholding tax from Simon Landers' trading account. Photo/Glenn Jeffrey.

Landers said he had complained to the ASB about the situation and questioned whether it was correct.

"I have challenged it as much as I can. If it is right, it is morally wrong," he said.

An accounting source said the man appeared to have been caught up in a rare and unfortunate situation where the Income Tax Act 2007, in conjunction with the Companies Act 1994, treat foreign companies that go into liquidation in a similar manner to New Zealand Companies.

For New Zealand companies that go into liquidation, some of the return can be exempted from tax, but for foreign companies the exemption was zero.

However, the source said that if the man was not a trader, he would probably be able to claim the money back through his annual tax return.

Greg Haddon, a tax partner at Deloitte, said the case served as a warning to people investing in foreign shares.

"When you are going into international investments the tax rules are incredibly complex.

"What I am saying is, if you are investing be very careful and make sure your eyes are wide open. You can get a situation where these things arise."

Withholding tax is required to be paid to the Inland Revenue Department. Photo/Janna Dixon.

Haddon said he believed there would be some avenues for clawing back some of the tax, but said foreign share investment rules were complicated and anyone investing in overseas shares should get tax advice first.

"I would strongly suggest it, just to ensure you know what the implications of different strategies are."

But he admitted the cost of getting tax advice was high for investors with small amounts of money, and could run into the thousands of dollars.

"These rules have been in for a little while. Those with reasonable sized portfolios will be sorted. But for small investors they are difficult."

Haddon said it was probably better for a small investor to go via a local fund manager such as investing through KiwiSaver, as the manager would handle all the tax implications.

The Foreign Investment Fund rules were bought in around the time KiwiSaver was launched in 2007, and designed to stop people from avoiding paying tax on their overseas share investments.

Haddon said many overseas listed companies did not pay dividends, so the rules were designed to capture tax whenever a person sold their investments.

But he said there was an argument that some of the rules on international investment should be simplified.

"They are not really set up for small investors because of the complexity."

Haddon said the situation was compounded by the fact that the ETF had been wound up, which meant the investor had no choice in the matter.

"He went into an ETF that was a little unique and had a lot higher risk than some of the general ones.

"When it comes to higher risk investments, again it is buyer beware."

Landers said he decided to invest his money in the ETF because he believed the property market was overpriced and the returns on leaving money in the bank were poor.

He had not planned to cash up the investment any time soon.

Landers said losing the $2000 was not going to hurt him in the long term.

"But I could have just taken the $2000 and gone on an awesome holiday."

He said tax laws needed to be addressed as they were patently unfair.

What is an ETF?

• Exchange traded funds have become popular to invest in as they are a cheap way of getting access to a wider range of investments.
• They work by pooling investors' money in a fund which is listed on a stock exchange. Investors own units or shares in the fund.
• The fund then invests the money in a range of securities such as other sharemarket listed companies based on an index such as the NZX50 - an index of the 50 largest companies on the New Zealand Stock Exchange - and is invested in proportion to the size of the companies in that index.
• They typically have an entry investment as low as $500 but some online platforms offer access to them for as little as $5, opening ETFs up to a wide consumer base.
• They are also seen as attractive as they charge low fees compared to other investment funds, while providing diversification.