

International

Double tax agreements (DTAs)

DTAs are designed to solve the problem of double taxation between countries and provide more certainty of tax treatment for people and entities carrying on business in foreign tax jurisdictions.

This is achieved by providing that only one country will have priority taxing rights. When both countries impose tax generally a credit against tax paid in the other country will be allowed.

DTAs are in force between New Zealand and the following countries:

- Australia*
- Austria*
- Belgium
- Czech Republic*
- Canada
- Chile
- China
- Denmark
- Fiji
- Finland
- France
- Germany
- India
- Indonesia
- Ireland
- Italy
- Japan
- Korea
- Malaysia
- Mexico*
- Netherlands
- Norway
- Philippines
- Poland
- Russia
- Singapore
- South Africa
- Spain
- Sweden
- Switzerland
- Taiwan
- Thailand
- United Arab Emirates
- United Kingdom *
- United States of America

* In January 2008 the New Zealand and Australian Governments confirmed that they will negotiate a new DTA.

The New Zealand / Austria DTA is effective in New Zealand from 1 March 2008 for withholding taxes and for income years beginning on or after 1 April 2008 for other taxes.

The DTA between New Zealand and the Czech Republic was signed on 26 October 2007 and will come into force once both parties have given it legal effect.

The New Zealand / Mexico DTA is effective in New Zealand from 1 August 2007 for withholding taxes and for income years beginning on or after 1 April 2008 for all other taxes.

In late 2007 the Government announced that the New Zealand / UK DTA will be updated regarding exchange of information and recovery of tax debt.

Controlled foreign companies (CFCs)

The CFC regime imposes New Zealand tax on the notional share of income attributable to residents (companies and individuals) with interests in certain CFCs.

Central to the regime is the definition of a CFC. Where five or fewer New Zealand residents directly or indirectly control more than 50% of a foreign company, or where a single New Zealand resident directly or indirectly controls 40% or more of a foreign company (unless an unassociated non-resident has equal or greater control) that company is a CFC. For lesser interests the investment may be a foreign investment fund (refer Foreign investment funds, page 34).

Interests in CFCs must be disclosed by taxpayers in their annual tax returns. Failure to disclose can result in the imposition of penalties.

A New Zealand resident (either corporate or individual) with an 'income interest' of 10% or more in a CFC is subject to tax on a proportionate share of the CFC's income calculated on a New Zealand tax basis. The conduit relief mechanism (refer Conduit tax relief, page 18) may be used to reduce or eliminate tax on such attributed income to the extent the New Zealand resident is owned by non-residents and other criteria are satisfied.

The Government is currently working on proposals to reform the international tax rules, including the introduction of an exemption from income tax for the active income of CFCs (refer New developments – International tax rules review, page 54).

Grey list

The regime does not require income to be attributed from CFCs resident in 'grey list' countries except where the CFC is not liable to tax in that country, derives exempt income from carrying on a business outside its country of residence, or has received certain prescribed tax preferences. Countries presently on the grey list are:

- Australia, excluding Norfolk Island;
- Canada;
- Germany;
- Japan;
- Norway;
- Spain, excluding certain territories;
- United Kingdom; and
- United States of America, excluding its possessions and territories.

Foreign investment funds (FIFs)

The FIF regime is an extension of the CFC regime (refer Controlled foreign companies, page 33), which subjects persons with interests in certain foreign entities (which are not CFCs) to New Zealand tax. It also applies where the investor does not have a sufficient interest in a CFC to be taxed under that regime.

Examples of investment vehicles that are commonly classified as FIFs include foreign companies (including unit trusts), foreign superannuation schemes and life insurance policies issued by foreign entities not subject to New Zealand tax.

Generally, however, a New Zealand resident does not have an interest in a FIF when:

- the foreign entity in which the interest is held is a company or unit trust resident in a 'grey list' country (refer Controlled foreign companies, page 33) – this exemption does not apply to portfolio FIF interests (refer page 35) or interests in foreign superannuation schemes or life insurance policies; or
- the total cost of FIF-type interests held by an individual does not exceed \$50,000; or
- the interest is an 'employment-related foreign superannuation scheme'; or
- the interest is a 'qualifying foreign private annuity'; or
- a natural person acquired interests in foreign life insurance policies or foreign superannuation schemes before first becoming resident in New Zealand - these interests will be exempt from the FIF regime for the rest of the income year in which the individual first became resident and for the following three income years; and
- certain other limited exceptions apply.

Legislation enacted in April 2006 extended the exemption in respect of interests in foreign employment-related superannuation schemes. It widened the scope of the exemption to include interests held by returning residents as well as new migrants arriving in New Zealand from 1 April 2006 and provides a permanent exemption for interests acquired before the person becomes a New Zealand resident and interests acquired within the first five years of New Zealand residence.

New Zealand residents with an interest in a FIF are required to include in their New Zealand gross income the amount of FIF income calculated using one of the following six methods:

- the fair dividend rate (FDR) method (available for portfolio interests only); or
- the comparative value method; or
- the cost method (for portfolio interests only); or
- the deemed rate of return method; or
- the branch equivalent method; or
- the accounting profits method.

The choice of method is restricted by the nature of the interest held and the availability of information.

Where an interest is exempt from the FIF rules (eg the interest is a certain pension or annuity provided by a foreign entity) distributions will be taxed on a receipts basis in accordance with normal principles.

Interests in FIFs must be disclosed by taxpayers in their annual tax returns. Failure to disclose gives rise to potentially stringent penalties.

Portfolio FIF interests

Legislation enacted in December 2006 comprehensively reformed the rules governing the taxation of offshore portfolio equity investments.

The changes to the taxation of offshore portfolio equity investments impact investors with a shareholding or interest of less than 10% in a foreign company, unit trust, certain foreign superannuation schemes and all life insurance policies.

The new offshore portfolio investment rules apply from 1 April 2007 for most investors. However, a company, group investment fund or superannuation fund that intends to be a PIE could elect to delay the application of the new offshore tax rules until 1 October 2007.

The key changes to the taxation of offshore portfolio equity investments are:

- the 'grey list' no longer applies to investments that fall within the new regime;
- from the start of the 2007/2008 income year individual and family trust investors are taxable on the lower of their actual return (all gains and dividends) from their investments or 5% (the so called 'fair dividend rate' or 'FDR') of the opening market value of the investments each year;
- a deemed realisation occurs on 31 March 2007 for revenue account investors holding shares in grey list countries that become subject to the new regime. This crystallises tax liabilities (payment of the tax is able to be spread over three years) for these investors;
- shares in certain Australian resident listed companies are excluded from the new rules;
- temporary exclusions apply to holdings in Guinness Peat Group (GPG) and The New Zealand Investment Trust;
- if an individual's non-excluded investments have an aggregate cost of \$50,000 or less, the entire portfolio is excluded from the new rules and is taxed under the pre-existing rules; and
- all investments excluded from the new rules (either permanently or temporarily) continue to be taxed as they were before the introduction of the new rules.

Branch equivalent tax account (BETA)

Taxpayers who are taxed on attributed foreign income under the CFC or FIF regimes may elect to maintain a BETA. The BETA operates in a similar manner to the Imputation Credit Account (refer Dividend imputation, page 15) and Dividend Withholding Payment Account (refer Foreign dividend withholding payment, page 17) and helps avoid double taxation of attributed foreign income and foreign dividend income. Attributed foreign losses and attributed foreign investment fund losses cannot create BETA credits.

Payments to non-residents

Non-resident withholding tax (NRWT)

NRWT is imposed on the gross amount of dividends, interest (including redemption payments, ie discounts on commercial bills and bills of exchange) and royalties derived from New Zealand and paid or credited to companies and individuals not resident in New Zealand.

NRWT must be deducted at source and paid over to the Commissioner by the 20th of the month following the month of deduction. The rates of NRWT are generally as follows:

	Double tax treaty countries	Other
	%	%
• dividends	15*	15/30
• interest	10/15	15
• royalties	10/15	15

*Except Philippines 15 or 25%

NRWT is imposed on dividends at the rate of 15% to the extent fully imputed (or 0% in the case of non-cash dividends) regardless of the jurisdiction to which they are paid. In some cases NRWT is a minimum tax and the non-resident's net income may be subject to tax at full rates unless their liability is limited by a tax treaty.

NRWT of 0% applies to interest paid under the approved issuer levy regime (refer Approved issuer levy, page 37).

A possible reduction in the NRWT rates in New Zealand's DTAs with other countries is under consideration as part of the Government's review of the international tax rules.

Non-resident contractors' rules

New Zealand imposes an obligation on those making contract payments to non-residents in relation to certain contract activities undertaken in New Zealand to deduct non-resident contractors withholding tax (NRCWT). Contract activities generally relate to services but also include the granting of a right to use property in New Zealand. The NRCWT rate is 15% (or 30% for individuals and 20% for companies if the relevant paperwork is not provided). Some contractors will be eligible to apply for a certificate of exemption or a reduced rate certificate.

However, non-resident contractors do not have to apply for a certificate of exemption from withholding tax if they:

- are eligible for total relief under a double tax agreement; and
- are in New Zealand for less than 92 days in any 12 months.

In addition, payments for contract work amounting to less than \$15,000 in a 12-month period are exempt from NRCWT. In such cases contractors themselves are responsible for paying any New Zealand tax owing at the end of the year.

Foreign investor tax credit (FITC)

The FITC regime provides effective relief from NRWT payable on dividends derived where the New Zealand company also pays a supplementary dividend. The supplementary dividend is calculated with reference to imputation credits attached to the original dividend and its payment entitles the company paying the dividend to a tax credit. The supplementary dividend equals the liability to NRWT where dividends are fully imputed.

Conduit tax relief additional dividend

Where the conduit tax relief mechanism (refer Conduit tax relief, page 18) has been utilised a conduit tax relief company may pay an additional dividend to non-resident shareholders to pass on the benefit of the conduit tax relief. Both the ordinary dividend and the additional dividend will be subject to NRWT.

Approved issuer levy (AIL)

NRWT need not be deducted from interest paid on borrowings provided:

- the New Zealand borrower and overseas lender are not associated persons;
- the borrower is recognised as an 'approved issuer' by the Commissioner;
- the debt instrument is registered with the Commissioner; and
- the borrower pays a tax deductible levy (AIL), equal to 2% of the interest paid, by the appropriate date.

Any late payment of AIL will be subject to the compliance and penalties regime. Taxpayers with annual AIL liabilities of less than \$500 are able to make six-monthly, rather than monthly, payments.

Thin capitalisation

Thin capitalisation rules apply to New Zealand taxpayers controlled by non-residents, including branches of non-residents. The aim of the legislation is to ensure that New Zealand entities or branches do not deduct a disproportionately high amount of the worldwide group's interest expense. This is achieved by denying an interest deduction in New Zealand where, and to the extent that, the New Zealand entities in the group are thinly capitalised (ie excessively debt funded). An apportionment of deductible interest is required where the debt percentage (calculated as total group debt/total group assets of a New Zealand entity or group) exceeds both:

- 75%; and
- 110% of the worldwide group's debt percentage.

Use of the debt to asset percentage differs from most thin capitalisation models, which monitor an entity's debt to equity ratio. All interest (both related and unrelated party) is subject to apportionment.

Foreign-owned banks operating in New Zealand are subject to specific thin capitalisation rules that deny them interest deductions if they do not hold a level of equity equivalent to 4% of their New Zealand banking risk-weighted assets. In addition, banks are required to have sufficient equity to equity fund offshore investments that do not give rise to New Zealand taxable income in full.

The Government is considering possible changes to the thin capitalisation rules as part of its review of the international tax rules (refer New developments – International tax rules review, page 54).

Transfer pricing

The transfer pricing rules are based on OECD principles and require taxpayers to value for tax purposes all cross-border transactions with associates on an arm's length basis.

The transfer pricing rules apply to arrangements for the acquisition or supply of goods, services, money, intangible property and anything else (other than non-fixed rate shares), where the supplier and acquirer are associated persons. Similar rules apply to the apportionment of branch profits.

Various methods are available for determining the 'arm's length consideration'. The taxpayer is required to use the method which produces the most reliable measure of the amount that independent parties would have paid or received in respect of the same or similar transactions. The IRD has published guidelines which make it clear that documentation is required to support a taxpayer's transfer prices.