

TAX

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SIGNIFICANT CHANGES TO THE AUSTRALIAN DOUBLE TAX AGREEMENT

APPOINTMENTS TO TAX PRACTICE



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Two experienced tax lawyers have joined Bell Gully's tax practice. **Jarrod Walker**, who joins the team from another New Zealand firm, advises New Zealand and offshore clients on all aspects of New Zealand tax law. His areas of focus include financing structures, investment entities and corporate taxation. Jarrod also has extensive domestic and international experience as a banking and finance lawyer, including eight years at leading firms Clifford Chance and Allen & Overy, in Amsterdam, Hong Kong and London. **Umesh Patel** advises on a wide range of income tax, GST and Companies Act matters. He joins Bell Gully from another New Zealand law firm where he has been advising domestic and international clients on tax-effective structuring and the implications of newly enacted tax regimes for the last two years.

On 27 June 2009 the New Zealand and Australian governments signed a revised Double Tax Agreement (the **2009 DTA**) that, once in force, will replace the existing New Zealand-Australian Double Tax Agreement entered into in 1995 (the **1995 DTA**).

The 2009 DTA is materially different to the 1995 DTA and incorporates changes to almost every article.

This update addresses some of the more significant changes.

Reduced withholding rates

Dividends

The 2009 DTA retains the existing 15% withholding rate for dividends as a default position, but introduces a new 5% rate and a complete exemption from withholding.

5% withholding rate

The new 5% rate applies where a dividend is derived by a company that holds 10% or more of the voting power of the dividend-paying company.

Exemption from withholding

An exemption from withholding applies to dividends derived by companies that hold 80% or more of the voting power of the dividend-paying company in the 12 months

ending on the date the dividend is declared provided that one of the following tests is also satisfied:

- the recipient company is listed on the ASX or NZX (or another index approved by the IRD and ATO) or the recipient company's ultimate parent is listed on such an exchange (referred to as the "listing test"); or
- the recipient company's ultimate parent is resident outside Australia or New Zealand and would have been exempt from withholding tax on the dividend if the ultimate parent held the shares in the dividend-paying company directly (referred to as the "foreign residence test"). Currently, it appears that for a dividend paid by a New Zealand company, these criteria could only be satisfied if the ultimate parent was a US resident that could have benefited from a 0% rate of withholding under the revised New Zealand / United States treaty.

If the recipient company satisfies the 80% ownership test, but not one of the "listing" or "foreign residence" tests, the company may nevertheless benefit from the exemption if the revenue authority in the dividend-paying company's country of residence determines that a new "anti treaty shopping" rule does not apply. Broadly, in the case of a dividend paid by a



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New Zealand company to an Australian parent, the IRD will need to form a view that the main purpose of the Australian company's shareholding (or any transaction involving those shares) is not to obtain the benefit of the exemption.

As yet, the IRD has not published any guidelines on how this determination procedure will operate in practice. Our expectation is that many entities will need to apply for determinations given the large number of unlisted Australian companies that operate through New Zealand subsidiaries.

It is noteworthy that the 80% ownership test (a prerequisite to the application of the exemption) cannot be satisfied unless the dividend-paying company has been in existence for 12 or more months. The 12 month period is not reduced for new entities that pay a dividend within 12 months of incorporation.

Interest

The 2009 DTA retains the 10% withholding rate in respect of interest, but introduces a new exemption from withholding for financial institutions where interest is paid on a loan:

- to an unrelated borrower; and
- which does not form part of a "back-to-back" loan arrangement (no guidance is given to date as to what type of arrangements will constitute a back-to-back loan).

Restrictions on the application of the exemption mean that, for New Zealand sourced interest, the new exemption from withholding will only apply if Approved Issuer Levy is paid (where that regime is available) in respect of the interest. However, it is unlikely that these restrictions will operate in respect of interest paid to an Australian entity with a branch in New Zealand (because the Approved Issuer

Levy regime would not be available in these circumstances).

Royalties

The 2009 DTA reduces the maximum withholding rate on royalties from 10% to 5%. The definition of "royalty" has also been limited to exclude payments for the use of, or the right to use, industrial, commercial or scientific equipment.

Changes to the "permanent establishment" definition

The 2009 DTA introduces significant changes to the definition of "permanent establishment" (the profits of which are not exempt under the business profits article in the DTA). Some key changes are summarised below:

- A deemed permanent establishment will now arise where services are performed by an enterprise through an individual or individuals in the other country for more than 183 days in any 12 month period and (i) more than 50% of the enterprise's income in the period is from services performed in New Zealand or (ii) the services are performed in relation to the same project or connected projects.
- The definition of "substantial equipment" now only deems a permanent establishment to arise where a person "operates" substantial equipment in the other country for more than 183 days in any 12 month period. The previous wording was wide and, arguably, applied to deem a lessor under a cross-border dry lease of substantial equipment to have a permanent establishment in the country in which the equipment was used. The introduction of a 183 day test is also a positive development in that it ensures that a permanent establishment will not arise in the case of fleeting operation



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of substantial equipment in the other country (e.g. simply sailing a barge through New Zealand waters).

- A wider dependent agent deemed permanent establishment test now applies where an entity has a dependent agent that has and habitually exercises authority to “substantially negotiate” or conclude contracts on behalf of an enterprise. Previous wording had referred only to authority to “conclude” contracts. This change may have significant consequences for sales representative operations which involve the negotiation of contracts in New Zealand on behalf of Australian principals. In the past, negotiated agreements may have been forwarded to the Australian principal for “approval” to avoid the Australian principal having a permanent establishment in New Zealand under the dependent agent test.

New “time bar” for attribution of profits to a permanent establishment

The business profits article in the 2009 DTA now includes a seven year “time bar” that prevents the IRD and the ATO from making any adjustment to an attribution of profits to a permanent establishment. The seven year period runs from the date on which the taxpayer has filed its return in respect of the permanent establishment. The time bar does not apply in the case of fraud, gross negligence or wilful default, or where an audit has commenced within that seven year period.

This change means little for Australian residents that operate through New Zealand permanent establishments on the basis that those taxpayers already benefit from New Zealand’s four year statutory time bar. However, the change is significant for New Zealand residents that operate through Australian permanent establishments

because, at present, the Australian domestic law time bar does not apply to the allocation of profits to a permanent establishment.

Other important changes

The 2009 DTA also includes a raft of other important changes, including:

- A new tax exemption for seconded employees who are seconded for 90 days or less in any 12 month period.
- A new article provides that income derived by a person through a fiscally transparent entity will be treated as derived by the person under the 2009 DTA if the entity is treated as fiscally transparent in either New Zealand or Australia.
- A new article will exempt pension payments derived from the other country that would have been exempt from tax had the person remained a resident of that other country. In addition, lump sum payments made to a person under a retirement scheme in the other country will now only be taxable in that other country (and not the country of residence of the person).
- Specific dual residence tie-breaker rules for dual listed company arrangements deem a dual listed company to be resident in the country of its incorporation, provided that the company’s primary listing is also in that country.
- A new rule will claw back relief under the 2009 DTA for Australian residents that move to New Zealand and benefit from the “transitional residents” regime. There is no “mirror” rule for New Zealand emigrants to Australia.

Staggered application dates

The changes to the withholding rates for

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dividends, interest and royalties will apply on the first day of the second month after both the New Zealand and Australian governments have given legal effect to the 2009 DTA. All other changes will apply on the 1 April following the date on which legal effect is given to the DTA. Early indications suggest that the ratification process may be completed by November 2009.

Disclaimer: This publication is necessarily brief and general in nature. You should seek professional advice before taking any further action in relation to the matters dealt with in this publication.

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