NZ TAX IMPLICATIONS OF EXPANDING BUSINESS INTO AUSTRALIA

Note: The information in this section is of a summary nature, designed only to convey a broad understanding of the NZ tax implications of expanding business into Australia.

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- Selling goods in Australia without creating a permanent establishment there
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Australian Tax Rates

1. The standard Australian tax year starts on 1 July and ends on 30 June.

2. The Australian company tax rate for 2010-11 is 0.30.

3. Australian individual tax rates for the 2010-11 year (applying from 1 July 2010) are:

$0 - $6,000	Nil
$6,001 - $37,000	15c for each $1 over $6,000
$37,001 - $80,000	$4,650 plus 30c for each $1 over $37,000
$80,001 - $180,000	$17,550 plus 37c for each $1 over $80,000
$180,001 and over	$54,550 plus 45c for each $1 over $180,000

4. Australian individual tax rates for the 2010-11 year, for a person who is a non-resident of Australia for the full year, are:

$0 - $37,000	29c for each $1
$37,001 - $80,000	$10,730 plus 30c for each $1 over $37,000
$80,001 - $180,000	$23,630 plus 37c for each $1 over $80,000
$180,001 and over	$60,630 plus 45c for each $1 over $180,000

Some Ways Of Commencing Business In Australia

5. The simplest way is to continue operations in NZ as usual and commence business operations in Australia as a non-resident of Australia. If more of a presence is warranted there, a branch or a company could be established or even a partnership with Australians. These are just some of the ways of expanding into Australia and they all have different NZ tax consequences.

6. From a tax perspective, the most important concern will be ensuring that the same business profits are not taxed in both countries. The NZ company tax rate is currently lower, so it will probably be preferable to pay tax here. In addition, NZ tax results in imputation credits for NZ companies. Individual marginal rates of tax are also lower in NZ.

7. There will obviously be Australian compliance obligations. It may be necessary to apply for an Australian Business Number ("ABN"): here is a link to the Australian Tax Office website: http://www.ato.gov.au/.

Expanding Current Operations Into Australia

8. When commencing business operations in Australia, there are certain "can do's and can't do's", so as to operate without creating a permanent establishment in Australia. A permanent establishment is essentially a branch. Business profits from Australia will be taxable in Australia if a permanent establishment is created.

9. The PDF attachments set out the "can do's" and the "can't do's", of operating without a permanent establishment in Australia, in relation to the sale of goods, and the provision of services, respectively.

GST Implications

10. Goods that are exported to Australia and meet the NZ GST requirements for zero-rating can be zero-rated.

11. Services that are physically performed in Australia, or that are the arranging of services that are physically performed in Australia, can also be zero-rated. Services supplied in NZ to an Australian resident can be zero-rated, providing that the recipient is outside New Zealand at the time the services are performed, and the services are not any of the following types of services:

> (a) Services supplied directly in connection with land situated in New Zealand or any improvement to land in New Zealand.
>
> (b) Services supplied directly in connection with moveable personal property, other than intellectual property, that is situated in New Zealand at the time the services are performed.
>
> (c) Services that constitute the acceptance of an obligation to refrain from carrying on a taxable activity, if that activity would have occurred within New Zealand.

Establishing A Branch In Australia

12. If a New Zealand enterprise carries on business in Australia through a permanent establishment in Australia, the profits of the NZ enterprise that are attributable to the permanent establishment can be taxed in Australia. In determining such profits, deductions are allowed for expenses incurred for the purposes of the permanent establishment, including executive and general administrative expenses incurred in NZ.

(a) Foreign tax credit for Australian tax payable

13. The profits of the permanent establishment will also be taxable in New Zealand, but a foreign tax credit can be claimed for tax paid in Australia, under the NZ foreign tax credit rules. These rules are strict, and a credit for tax paid in Australia cannot be carried forward if it is not used.

14. Under the foreign tax credit rules, income from Australia is divided into segments, with each segment being income from a particular source or of a particular nature. The NZ tax credit for each segment is limited to the proportion of the notional NZ tax payable for the year that is attributable to that segment.

15. The notional NZ tax payable is the NZ tax that would be payable on the net income for the year, after subtracting any losses carried forward, but before any

tax credits. The proportion of NZ tax attributable to the income from a segment is: the income from the segment less allowed deductions attributable to the segment, as a proportion of net income for the year.

16. If the tax balance dates of the New Zealand enterprise and the Australian permanent establishment are not aligned, income from Australia will have to be apportioned to the income years in New Zealand in which that income was derived. There is a concession that applies if income from Australia, in an Australian tax year, does not exceed $100,000: the NZ enterprise can elect to return all of the Australian income in the New Zealand income year in which the Australian tax year ends.

17. The calculation of the net profits returned by the permanent establishment in Australia should match (as far as possible) the net income from a segment for NZ tax purposes. It will be important to keep this objective in mind when preparing the tax returns in Australia and in NZ, which may well be done at different times.

18. Ensuring that Australian tax is fully creditable in New Zealand can, therefore, be a tricky process. The rules need to be properly understood and carefully followed.

(b) Transfer pricing, thin capitalisation and withholding taxes

19. The transfer pricing rules in Australia and in New Zealand will be important in determining the price of services performed in New Zealand and charged to the Australian permanent establishment, and the apportionment of executive, general and administrative expenses.

20. If interest deductions are to be claimed by the Australian permanent establishment, it will be necessary to ensure that such deductions are not denied under the Australian thin capitalisation rules.

21. If interest is paid on indebtedness connected with the Australian permanent establishment, and the interest is deductible in determining the profits attributable to the permanent establishment, the interest will be deemed to arise in Australia. The same applies to royalties incurred in connection with the permanent establishment and deductible by the permanent establishment. In either case, there will be Australian withholding tax implications.

(c) Employee taxation

22. Income earned by a NZ tax resident from employment exercised in Australia may be taxed in Australia if any of the following conditions are met:

- The recipient is present in Australia for more than 183 days in any 12 month period.
- The income is paid by an Australian tax resident employer, unless it is paid, and tax deductible in NZ, by a permanent establishment which the Australian employer has in NZ.
- The income is paid by a permanent establishment in Australia, or, it is tax deductible by a permanent establishment in Australia.

23. There is a special exemption in the double tax agreement with Australia under which, employment income derived by a NZ employee during a "secondment" to Australia will only be taxable in NZ if the employee is present in Australia for a period or periods that, in aggregate, do not exceed 90 days in a 12-month period. [Paragraph 4, Article 14 of the double tax agreement with Australia]

24. Therefore, if a NZ employee is "seconded" to an Australian branch for not more than 90 days in a 12-month period, there should be no Australian tax obligations. However, this may have to be pre-approved by the Australian Tax Office.

25. In relation to "secondment", paragraph 5 of Article 14 of the double tax agreement with Australia provides:

"5. *For the purposes of paragraph 4, "secondment to the other Contracting State" means an arrangement pursuant to which an employee of an enterprise of a Contracting State, being the enterprise with which the employee has a formal contract of employment, temporarily performs employment services in the other State for a permanent establishment of the enterprise situated in that other State, or for an associated enterprise (as referred to in subparagraph (c) of paragraph 6 of Article 5), where such employment services are of a similar nature to those ordinarily performed by that employee for the first-mentioned enterprise. However, it does not include an arrangement that has as one of its main purposes the obtaining of benefits under paragraph 4.*"

26. If employees of the NZ enterprise work in the Australian permanent establishment, the employee tax obligations in Australia will need to be carefully thought through. If deductions properly attributable to the permanent establishment are not made when preparing the Australian tax return, there is potential for the Australian tax payable to exceed the NZ foreign tax credit.

(d) NZ partnerships, limited partnerships and look-through companies

27. An Australian permanent establishment of a NZ partnership or a limited partnership will be taxed as a partnership. The double tax agreement with Australia will apply only to NZ resident partners. The NZ resident partners will each be regarded as having a permanent establishment in Australia.

28. An Australian permanent establishment of a look-through company will be taxed as a company in Australia. From a NZ tax perspective, the individual LTC owners will be treated as having derived the Australian income and the LTC rules will apply. The foreign tax credit rules described above will apply to each LTC owner.

29. In the case of an LTC, whether or not the double tax agreement with Australia applies will depend on the residence of each LTC owner. Paragraph 2 of Article 1 of the double tax agreement with Australia provides that when an item of income is derived by or through a person that is fiscally transparent in NZ, the item is

treated as derived by a NZ resident only to the extent the item of income is treated under the tax law of NZ as having been derived by a NZ resident.

Operating Through An Australian Company

30. If a company is established in Australia, it will be a controlled foreign company ("CFC") for NZ tax purposes. However, there will most probably be no attributed CFC income or loss because the Australian company will be regarded as a non-attributing Australian CFC.

(a) Provision of personal services through an Australian CFC

31. Care needs to be taken when personal services are provided through an Australian company. If the Australian company derives income from the supply of personal services of a specified type (as described below), a NZ owner of the company will have attributed CFC income equal to the product of:

(a) The person's income interest in the CFC; and

(b) The amount by which the CFCs income from personal services exceeds the expenditure incurred by the CFC in deriving the income from personal services.

32. The specified type of personal services is: personal services performed by a "working person" who is a New Zealand resident, that meet all of the following criteria:

(a) The personal services are not essential support for a product supplied by the CFC.

(b) The working person is associated with the CFC at the time the services are performed or is a relative, at the beginning of the CFC's accounting period, of a person associated with the CFC.

(c) 80% or more of the CFC's total income in the accounting period from supplying personal services is derived through personal services that are not essential support for a product supplied by the CFC, and that are performed by a working person who is either associated with the CFC, or a relative of a person associated with the CFC.

(d) The cost, at the end of the CFC's accounting period, of depreciable property (if any) used by the CFC to derive the income, does not exceed the *greater* of:

(i) $75,000; and

(ii) 25% of the CFC's total income from personal services performed in the accounting period.

(b) Transfer pricing, thin capitalisation and withholding taxes

33. Transactions between a New Zealand company and an Australian subsidiary will be subject to transfer pricing rules.

34. The interest deductions claimed by an Australian company will be subject to Australian thin capitalisation rules.

35. Australian withholding tax rules will apply to the payment of interest or royalties by the Australian company to a NZ resident.

(c) Dividends

36. Dividends paid by the Australian company will be subject to Australian withholding tax. But the withholding tax will be limited to:

- 0% if the beneficial owner is a NZ listed company that has held 80% of the shares in the company paying the dividend for at least 12 months.
- 5%, if the beneficial owner is a NZ company that holds directly at least 10% of the voting power in the Australian company.
- 15% in all other cases.

37. If derived by a company, the dividend will be exempt in New Zealand, unless the income interest in the Australian company is less than 10%.

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