

JURISDICTION TO TAX: RESIDENCE & SOURCE

X is **obliged to pay income tax** if:

1. You are **resident** in New Zealand (obliged to pay on **worldwide income**)
2. Your income has a New Zealand **source** (**irrespective** of whether you are a resident or not)

Income is Assessable Income Unless s BD 1(5)

- Exempt income (ex: non-resident during visits of 92 days or less s CW 19)
- Excluded income (GST + FBT)
- **Non-residents' foreign-sourced income s BD 1(5)**

RESIDENCE OF NATURAL PERSON YD 1

Is "X" a NZ Resident and Liable to Income Tax on Worldwide Income?

Does "X" Have a Permanent Place of Abode YD 1(2)?

Provision

YD 1(2): *Despite anything else in this section a person is a New Zealand resident if they have a permanent place of abode in New Zealand, **even if they also have a permanent place of abode elsewhere***

The use of "despite anything else in this section" suggests that this is the prevailing test to use

Permanent Place of Abode Clarified by the CL

- Contentious element is '**permanent**' – it is something less than everlasting but more than temporary **FCT v Applegate**
- This is objectively assessed – factors include **Case Q55**
 - **Reason for going overseas?**
 - NZ employment indicates PPA; overseas employment indicates not PPA
 - **Arrangements taken which show an intention that NZ is home?**
 - NZ house does not have to be vacant so long as it is available for TP to live when required
 - Fact that it is rented out does not mean PPA is extinguished (in **Q55** could terminate rental unilaterally)
 - **Whether TP continued enduring relationship in NZ?**
 - Employment: maintaining NZ employment indicates PPA
 - Financial ties: NZ salary, investments, property, NZ bank account still open indicate PPA
 - Other ties in NZ: member of various clubs and societies indicates PPA
 - **Length of time outside of NZ?**
 - 368 days not particularly long in **Q55**

How to avoid PPA Q 55:

Quitting NZ job, severing all bank a/c's, memberships, hometown UK on Facebook

"183 Day" Test: Has X Been Personally Present in NZ for More Than 183 days in a 12month period? YD 1(3)

Requirements

- Applies to ANY 183 days within 12 months - *does not have to be consecutive*
- Person is treated as a *resident from the first of the 183 days* YD 1(4)
- Will remain a NZ resident *until residency ceases* per YD 1(5)

What happens if all 183 days are not in the same financial year? It does not matter. So long as it is within a 12-month period you are considered a resident.

What happens if you return to NZ for three days for a job interview and then return permanently 3 months later? You would be treated as a resident from the date you came back. You would be treated as a resident for the first of the three days.

For example – born in NZ; leave NZ for Dubai for 5 years to work (no longer resident per YD 1(5)); return to NZ for 1 week to see family; fly back to Dubai for 1 week, get \$100k redundancy; fly to NZ and remain for life. **You are a resident from the week you flew back – redundancy subject to income tax.**

"325 Day" Test: When Does X's Residency Cease, so that they are no longer liable to pay tax on worldwide income? sYD 1(5), (6)

Requirements

- New Zealand residency ceases when "personally absent from NZ" for more than 325 days in total in a 12-month period" *sYD 1(5)*
- X treated as a **Not Resident from the 1st of the 325 days:** *sYD 1(6)*

THIS TEST IS SUBORDINATE TO PPA TEST: if NZ is PPA and absent for over 325days, still a NZ resident and liable to tax on worldwide income

Exception = individual absent from NZ and in the NZ Government Service is treated as a New Zealand resident during the absence *s YD 1(7)*

If X was *not a resident*, s BD 1(5) would protect X from New Zealand tax, as his income would be classed as *non-residents' foreign-sourced income* which is not subject to income tax

What is Meant by Permanent Place of Abode?

FCT v Applegate 79 ATC 4307 (the Sydney solicitor who went to Vila)

- **Facts:** in 1972 TP, a solicitor was sent to Vanuatu to open and manage a branch office. In 1973 TP became ill and returned to Sydney.
- **TP claimed:** Vila income exempt from Australian income tax as he was not a resident at that time.
- **Issue:** Did TP have a PPA in Vanuatu?
- **Held:** exempt from paying Australia tax. PPA is something less than 'domicile' but more than temporary - this is to be judged annually.
- **Factors: objective test**
 - Intention to length of time to remain over seas

- Intention to establish a place of residence outside home country
- Continuity of TP presence
- Duration of TP presence o/seas
- Durability of association with o/seas place.
- Intention to return home not fatal to having overseas permanent place of abode.
- Permanent place of abode means "fixed and habitual" place of abode.
- Whether you retain a bank account in the jurisdiction

Case Q55 (1993) (the university professor)

- **Facts:** Uni prof went on 368 day sabbatical – while away rented out home (retained ownership) for a fixed term which could be terminated unilaterally
- **Factors for:** stored furniture, maintained NZ bank accounts, kept memberships to NZ clubs and societies, continued and contributed to NZ superannuation scheme
- **Factors against:** rented apartments and had bank accounts in England and Germany
- **Held:** PPA in NZ. Liable to pay NZ income tax on ALL worldwide income throughout the period

Tax Information Bulletin – a magazine put out by the IRD. Not binding – nor is it even an interpretative aid. But usually you can rely on it to arrange your affairs.

RESIDENCE OF COMPANIES YD 2

Is the Company a NZ Resident and Liable to Pay Income Tax on Worldwide Income?

A Company is a New Zealand Resident If YD 2(1)

- Incorporated* in NZ; or
- Head office* is in NZ; or
- Centre of management* is in NZ; or
- The directors, in their capacity as directors, exercise *control* of the company in New Zealand, even if the directors' decision-making also occurs outside New Zealand.

Without these rules companies would incorporate in another country and appoint some people overseas as company directors (relaying decisions to them from time to time). This would escape income tax liability in NZ as not NZ resident.

De Beers Consolidated Mines Ltd v Howe [1906] (the classic case for centre of management)

- **Facts:** TP (mining company) incorporated in SA. Head office and actual mining in SA. But majority of companies directors lived and decision making took place in London UK.
- **Issue:** is company resident of SA or UK?
- **Held:** resident of UK
 - Companies residence is where its real business is carried out irrespective of where it is registered
 - 'Real business' is carried on where the central management and control occurs and is exercised. Directors made major decisions in the UK.
 - "Centre of management and control" – if the directing power of the company is at the office where the chief operations are controlled, managed and directed – the place where such an office is located should be deemed as resident for tax purposes.

New Zealand Forest Products Finance NV v CIR [1995] 2 NZLR 357 NZHC (a tax haven case)

- **Facts:** NZFP est'd subsid - incorporated + registered in Caribbean (tax haven). Function was to obtain overseas finance for the group of companies – over \$200m was raised. Board of

directors held all meeting outside NZ; shareholder meetings took place in Netherlands; ongoing administration carried out by trust company resident in Netherlands.

- **Issue:** was subsidiary a resident of NZ?
- **Held:** company was not resident of NZ therefore no withholding tax was payable – applies centre of management and control test as created in *De Beers*
 - Centre of management and control were at all times outside NZ
 - All decisions by directors and shareholders were made overseas
 - Evidenced by the fact that directors were no mere pawns of the parent company– made own decisions independent of parent i.e. no rubber stamping parent company
 - Was truly a foreign subsidiary

SOURCE

Income derived from New Zealand is subject to New Zealand tax whether the person receiving the income is a New Zealand resident or not

AIM OF SOURCE RULES IS TO:

- Reduce uncertainty
- Prevent tax avoidance
- Provide some kind of **apportionment where income is derived partly from NZ and partly elsewhere**
- ***Non-residents' foreign sourced income is exempt from tax – s BD 1(5)***

Does the Income Fall Within One of YD 4's Source Rules?

THE NATURAL PERSON/COMPANY IS NOT A RESIDENT

HOWEVER, income **sourced in NZ and income tax attributable to it needs to be paid**

1. Is the Business in New Zealand? YD 4(2)

- If business is wholly or partly carried on in NZ, then income derived from the business is sourced in NZ. *sYD 4(2)*
- If partly the income must be apportioned under *YD 5*
- For example, solicitor meets and talks to client in UK, drafts and sends letter in NZ

2. Are Contracts Made or Performed in New Zealand? YD 4(3)

Income derived by a person from a contract has a source in New Zealand if the contract is:

- a) made in New Zealand, except to the extent to which the person wholly or partly performs the contract outside New Zealand, and the income is apportioned to a source outside New Zealand under YD 5:
- b) made outside New Zealand but the person wholly or partly performs the contract here, to the extent to which the income is apportioned to a New Zealand source under YD 5.

3. Are the Personal Services in New Zealand (Employment)? YD 4(4)

- If amount is income under CE1 (amounts derived in connection with employment – i.e. wages, salary etc) it has a source in NZ
- "Earned in NZ even if the **employer is not a New Zealand resident**" *YD 4(4)*

4. Accident Compensation Payments YD 4(5)

5. Pension? YD 4(6)

- Has a source in New Zealand if payable:
 - (a) By the New Zealand government; or
 - (b) Out of any superannuation scheme established in NZ

6. Income from Land in NZ YD 4(7)

- Income "derived by a person as the **owner** of land in New Zealand" has a source in NZ
- So where you own land but are not a resident – income derived from the land = sourced

7. Income from Personal Property? YD 4(8) – i.e. renting

- The payments for USE or RIGHT TO USE have a source in New Zealand if:
 1. Paid by a New Zealand resident; or
 2. Paid by a non-resident, but are deductible by that person for New Zealand tax purposes.

Specifically maintains taxation symmetry between taxability and deductibility:

8. Royalties? YD 4(9)

- Source in NZ if:
 1. Paid by a person who is resident in New Zealand (unless in respect of a business carried on outside New Zealand through a permanent establishment outside New Zealand); or
 2. They are paid by a person who is not resident in New Zealand, (but are deductible by that person for NZ tax purposes.)
 - If rule didn't exist, could initiate +ve tax planning: deductible when paid AND not taxable on receipt. = immediate tax advantage and net loss for the government.
- s CC 9(2) royalty includes any payment in respect of:
 1. Copyright; patents; trademarks; designs; models; plans; secret formulas; etc;
 2. Mines and quarries;
 3. Timber or natural resources;
 4. Films; videotapes; sound-recordings;
 5. Scientific, technical, industrial or commercial information;
 6. Assistance in connection with the above;
 7. Forbearance in connection with the above.

Rules for royalties are extensive as:

- Aimed at tax avoidance; Royalties are attractive to taxpayers as they aren't tangible AND can be moved easily – (e.g. register intellectual property in a tax haven.)

9. Dividends? YD 4(10)

- Income derived from shares in a company resident in New Zealand has a source in New Zealand.

10. Debt Instruments? YD 4(11)

- The following have a source in NZ and are taxed:
 - **Interest and redemption payments:** (i.e. \$90bonds) derived from money lent in NZ- YD 4(11)(a)
 - "redemption payment" defined as amount by which a payment on a commercial bill exceeds the money lent. YA 1.
 - "interest" is payment for money lent whether periodical or not. YA 1
 - **Interest and redemption payments** derived from money lent outside NZ if: sYD 4(11)(b)
 - (i) the money is lent to a NZ resident (unless the money is used by that person for the purposes of a business carried on by that person outside NZ through a fixed establishment outside NZ); **OR**
 - (ii) the money is lent to a person who is non-resident, if the money is used by that person for the purposes of a business carried on by that person in NZ through a fixed establishment in NZ.
 - **Securities issued** by the NZ government; sYD 4(11)(c)

- Income derived from debentures issued by a local authority or a public authority in NZ; sYD 4(11)(d)
- Income derived from a mortgage of land in NZ; sYD 4(11)(e)
- **The above parallels the treatment of royalties!**
 - **Why is YD4(11)(a) important? 30 years ago this rule did not exist.**
 - Non resident NZ'er would lend to non-resident individual in tax haven using redemption debt instrument.
 - +ve tax advantage when: The non-Resident borrower would DEDUCT the redemption payment, AND the NZ lender was not taxed on receipt of redemption payment.

10. Income from Disposal of Property?: YD 4(12)

- Sourced if property situated in NZ. YD 4(12)

11. Beneficiary Income? YD 4(13)

12. Income derived from Air Transport? YD 4(14)

- If left from NZ

13. Income derived from Sea Transport? YD 4(15)

- If leaves from NZ

14. General Insurance? YD 4(16)

- Certain income of non-residential general insurance s YD 4(16)
- **Used to gain positive tax advantages by shifting insurance company to a tax haven.**
The insured would deduct cost of premium payments to insurance company, AND insurance company would not pay tax on the receipt of premiums.

10. Life Insurance YD 4(17)

11. Other? YD 4(18) Residual Catchall

- "Income derived directly or indirectly from any other source"

The Significance of Source

The source of income is significant for two main reasons:

1. non-residents pay New Zealand tax on income having a New Zealand source;
2. New Zealand residents are entitled to credit for foreign taxes paid on income not having a New Zealand source. Foreign tax credit which prevent double tax!

INCOME I: GENERAL PRINCIPLES

Introduction

- Traditionally “income” not a hard to interpret as was not as extensive as now. Courts developed a **body of case law that answered when a receipt was income**
- P refused to accept the Court’s definition of income – **it was too narrow and excluded too many items, which did not provide govt. with enough money**
- P enacted specific rules incrementally expanding the definition of income to fill the gaps, which the courts had created
- Gaps in the legislative scheme are a problem rectified by the courts – **courts can hold income to be under “ordinary concepts”**

Distinguishing Between Income/Capital Gains

- Important in our tax system as there are no capital gains taxes in NZ
- It is more than a question of whether the TP’s actions constitute a business for taxable receipts
 - Sometimes you **sell a car and the proceeds of sale are taxable, sometimes not.** If sold by a **car salesman as a business** then proceeds of sales are taxable.
 - If less than a business proceeds might/might not be taxable. To determine this you must ask: what was the salesman’s **purpose for acquiring the car?** If you acquire the car for yourself and don’t end up selling it the proceeds are not taxable. If you acquire the car to sell it then the proceeds are income and thus taxable.
 - Although the ultimate test is a purpose test, the period of ownership is a very powerful indicator: if you buy a car and within a week sell it, the inference is that you bought it with the intention of selling it.

Issue 1: Whether X’s Receipt is classed as Income Under the ITA?

s CA1: An amount is income if it comes:

- **Under a provision in Part C** s CA 1(1); OR
- Under **ordinary concepts** CA 1(2)

Issue 2: Does X’s Receipt Fall Under Any Specific Subparts CB – CV?

Contents:

- 1) **Business or Trade-Like Activities**
- 2) Income from **Holding** Property (Rents, Interest, Royalties, Dividends)
- 3) Dividends
- 4) Employee or Contractor Income (**Restrictive Covenants, Exit Inducements**)
- 5) Government Benefits
- 6) Recoveries (Over-Depreciated, Cancelled Liabilities, Insurance for Trading Stock)
- 7) Adjustments (**Trading Stock as Income**)

Subpart CB “Income from Business or Trade-like Activities” [**Go to Part III**]

- Includes:
 1. Income from business: ss CB 1 and CB 2;
 2. Profit-making undertakings and schemes: s CB 3;
 3. Income from **dispositions of personal property:** ss CB 4 and CB 5;