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INLAND REVENUE DEPARTMENT, HEAD OFFICE, P.O. BOX 2198, WELLINGTON, TELEPHONE: 721 032

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DOUBLE TAXATION CONVENTION WITH THE UNITED STATES OF AMERICA – 1982

PART I – INTRODUCTION AND GENERAL SUMMARY

A new double taxation convention has been concluded between the United States of America and New Zealand which replaces the Agreement signed at Washington on 16 March 1948 between the two countries. The text of the new convention has been published as a schedule to an Order in Council (S.R. 1983/196) which was recently distributed to district offices and is also available from Government Bookshops.

The Convention came into force on 2 November 1983 with effect in New Zealand:

(a) for any income year beginning on or after 1 April 1984;

(b) from 1 April 1982 in the case of dividends beneficially owned by a resident of the United States. Since 1 April 1982 dividends paid to residents of the United States have been subject to non-resident withholding tax at the New Zealand domestic rate of 30 percent. As the Convention came into force before 1 April 1984 the treaty rate of 15 percent applies from 1 April 1982 to dividends paid by a New Zealand resident company. Taxpayers may obtain refunds of tax overpaid by applying to the Dunedin District Office of the Department.

In the United States it takes effect:

(a) on 1 January 1984 in respect of taxes withheld at source;

(b) for taxable years beginning on or after 1 January 1984.

There is no need for transitional provisions in this Convention as the 1948 Agreement ceases to apply when the provisions of the 1983 Convention take effect.

N.B. The new Convention is generally drafted in accordance with the 1977 OECD Model Double Taxation Convention. The notes and commentaries in the OECD booklet "Model Double Taxation Convention on Income and Capital" are therefore useful resource material in understanding the application of the Convention. Care should be taken to identify differences in the text of the Convention from that in the Model if using those notes and commentaries as an aid in the interpretation or application of this new Convention with the United States.

PART II – NOTES ON THE CONVENTION ARTICLE BY ARTICLE

Article 1 – General Scope

(1) The Convention applies to persons who are **residents** of New Zealand or of the United States or of both States except as otherwise provided.

(2) Paragraph 2 confirms the principle that the Convention should not take away any benefits given under the domestic law of a country or other Agreement by way of exclusion, exemption, deduction, credit or other allowance. Although this provision is not in any of our other double taxation treaties it is a principle which New Zealand adheres to in the interpretation of double tax treaties.

(3) Paragraph 3 and paragraph 4 are the most significant departures from New Zealand's other double taxation treaties and are included at the request of the United States.

The reason for the provision in paragraph 3, known as the "saving clause", is that the United States views treaties as affecting a Contracting State's right to tax residents and citizens of the other Contracting State, and not its right to tax its own residents and citizens.

The United States considers the "saving clause" is necessary for the United States to retain its statutory right to tax its citizens and residents on world-wide income. The United States also retains the right to tax a former citizen on United States source income for a 10 year period if the former citizen renounced citizenship to avoid United States tax.

New Zealand does not consider for its part that a "saving clause" is necessary to allow taxation of New Zealand residents on world-wide income.

Example

A United States citizen who lives in New Zealand and who is under Article 4 of the Convention a "resident of New Zealand", derives dividends from the USA amounting to $100.

Assuming that this person's New Zealand tax rate on the dividends, after taking into account all income derived, is 45 cents in $1, while in the United States by applying the same basis the rate is 60 cents in $1, the position would be as follows:

1st level	US tax is limited under Article 10 of the Convention to 15 percent of $100	$15
2nd level	NZ tax on $100 at 45 cents less credit for tax paid under Level 1	30
		$45
3rd level	US tax on $100 at 60 cents less credit for tax paid under Levels 1 and 2	15
	Total Tax Paid	$60

Under the credit provisions of Article 22 the credit available against the New Zealand tax payable is limited to the tax levied by the United States under Level 1.

See also the example set out in the notes on Article 22.

(4) Paragraph 4 sets out the exclusions from the application of paragraph 3.

Example

Article 9 of the Convention provides safeguards against trading between associated parties, e.g., if a New Zealand company which is a subsidiary of a United States company has been overcharged by the United States company for its purchases, the New Zealand company's profits would be increased to the extent of the excess charged.

The United States company as a consequence would request the United States Tax Authorities to adjust its profits to prevent double taxation. The adjustments made by the New Zealand Inland Revenue are in accordance with Article 9(2). The benefit the United States company is claiming from the United States Authorities could be denied under Article 1(3) but for the exclusion provided for by Article 1(4).

Article 2 – Taxes Covered

The Convention covers income tax for both countries and excise taxes imposed on private foundations by the United States. The latter tax is imposed effectively in lieu of income taxes. It would cover such situations as a person purchasing a painting and donating it to a foundation for exhibition purposes for part of the year only. Excess retention tax and bonus issue tax imposed by New Zealand are excluded from the Convention and the United States equivalents of excess retention tax being accumulated earnings tax and personal holding company tax are also excluded.

Film Hire tax is not covered by this Convention.

Article 3 – General Definitions

(1) This Article groups together a number of general provisions required for the interpretation of the terms used in the Convention.

(2) Paragraph 2 makes it clear that the terms "New Zealand tax" and "United States tax" do not include penalties or interest imposed.

(3) Paragraph 3 is a standard provision. Where a term is not defined it has the meaning applicable under the domestic law of the country applying the Convention.

Article 4 – Residence

(1) Paragraph 1 defines the meaning of the term "resident of a Contracting State". In effect the defined term is a reference to the domestic law of each country. Whenever the term is used in the Convention, the residence of the taxpayer must first be determined in accordance with this Article.

The thrust of this first sentence concentrates on the idea of physical presence in a country but because the United States' basis of taxation in many cases is based solely on "citizenship" it was necessary to include that term. Paragraph 1 (a) precludes a United States citizen living in, say, a tax haven, or a country other than the United States or New Zealand, saying that he is a "resident of the United States" and claiming the benefits provided by the Convention such as reduced rates of non-resident withholding tax or the 183 day rule in Article 15 (Dependent Personal Services).

Paragraph 1 (b) provides that a partnership, estate or trust will only be regarded as a "resident of a Contracting State" if its income is taxed in its hands or the hands of its partners or beneficiaries. Partnership is included here as certain United States partnerships are liable to tax as an entity.

Finally paragraph 1 provides that non-taxable organisations such as charities will receive the benefit of the Convention such as reduced non-resident withholding tax rates for interest, dividends or royalties, e.g., if a United States charity invested money in New Zealand and was exempt from tax in the United States it could be argued that the Convention does not apply to the charity under the first paragraph of this Article as it is not "subject to tax therein" and New Zealand could impose 30 percent non-resident withholding tax on the dividends as the charity could not be exempt from tax in New Zealand. This provision ensures that the Convention applies and that New Zealand's non-resident withholding tax is limited to 15 percent under Article 10.

(2) Paragraph 2 sets out the tests to be applied to solve the problem of a dual resident individual. Dual residence arises when a taxpayer is resident in both countries by virtue of the domestic law of each country.

(3) Paragraph 3 provides that where a person other than an individual or a company (e.g., estate or trust) is resident in both countries the competent authorities shall endeavour to settle the question by mutual agreement.

(4) Paragraph 4 provides that where a company is resident in both countries the competent authorities shall endeavour to settle the question by mutual agreement and where they are unable to agree they shall be treated as a resident of neither for the purpose of the Convention.

In applying the tests to dual residents as set out in paragraphs 2, 3 and 4 it should be remembered that these tests apply only for the purposes of the tax convention. If the person **resident in New Zealand** (domestic law test) becomes for the Convention a "Resident of the United States" after the tests have been applied, this does **not** mean that he is a non-resident for all purposes of New Zealand tax law. For example, he can never be subject to non-resident withholding tax, the reason being that although he is treated as a non-resident for certain purposes of the Convention, he is still a resident under the New Zealand Income Tax Act. What it does mean is that he is entitled to any benefits granted by the Convention as a "resident of the United States". For example, although New Zealand royalty income derived by him is not subject to non-resident withholding tax, he is liable for New Zealand income tax on the royalty income but qualifies for the 10 percent limitation in the Convention.

Article 5 – Permanent Establishment

This Article defines the term "permanent establishment". This concept determines the right of a Contracting State to tax the profits of an "enterprise of the other Contracting State". Due to the inclusion of the words "includes especially" in paragraph 2, the examples cited as constituting a permanent establishment are by no means exhaustive.

The definition of "permanent establishment" is fairly standard; however the following points should be noted:

Paragraph 3 — A building site or construction or installation project constitutes a permanent establishment if it lasts for more than 12 months.

Paragraph 4 — An enterprise shall be deemed to have a permanent establishment if it carries on for more than 12 months supervisory activities in connection with a building site or construction or installation project.

Paragraph 5 — An enterprise shall be deemed to have a permanent establishment if it carries on for more than 6 months in any 12 month period activities in connection with the exploration or exploitation of natural resources. In this context "activities" includes the activities of supply ships and supply of labour. In applying this test where the activities of associated enterprises are connected they will be regarded as being carried on by a single enterprise.

For example, where an enterprise carries on activities for 5 months then transfers its activities to an associated enterprise which completes the project in say 3 months then both enterprises are deemed to have a permanent establishment.

Article 6 – Income from Real Property

This Article recognises the internationally accepted practice in relation to income from land or landed property. The Article also applies to such items as rents, natural resource royalties, farming profits, etc. The principle of the Article is that income from "real property" may be taxed in the country where the property is situated. "Real property" is not defined in our general law but the Article provides an extensive definition. Ships and aircraft are specifically excluded from the term "real property".

The Article involves no change in current practice in relation to the income covered, i.e., our domestic law applies.

Article 7 – Business Profits

This Article is in many respects a continuation of, and a corollary to, Article 5 on the definition of the concept of permanent establishment. Under Article 7 a Contracting State cannot tax the business profits of an enterprise of the other Contracting State unless it carries on its business through a permanent establishment situated therein. If a permanent establishment exists the Article goes on to lay down a set of rules by reference to which are to be calculated the profits of the permanent establishment.

Before dealing with the salient features of the Article some comment is warranted on the importance of paragraph 6. This is because reference to this Article and Article 5 will not always be necessary to determine the liability of specific types of income. In effect paragraph 6 gives first preference to the other Articles in the Convention. It follows that this Article will only be applicable to business profits which do not belong to the categories of income specifically covered in other Articles of the Convention, and in addition, to dividends, interest and royalties which **specifically** come within the **circumstances** detailed in paragraph 3 of Article 10, and paragraph 4 of Articles 11 and 12, and consequently fall within Article 7.

(1) Paragraph 1 expresses the general rule that profits are taxable only in the country of residence unless the enterprise is engaged in business in the other country through a permanent establishment, in which case the other country may tax the business profits of the permanent establishment.

It is important to note that only income attributable **directly** to the permanent establishment's operations can form part of the establishment's operations. This does not mean that income which is not directly attributable to the establishment's operations escapes liability for tax. For example, the restriction on the rate of tax imposed by paragraph 2 of Articles 10, 11 and 12, would still apply if such income did not arise from the permanent establishment's operations.

(2) Paragraph 2 contains the normal provision enabling arm's length profits to be attributed to the permanent establishment if necessary.

(3) Paragraph 3 expresses the taxpayer's right to deduct from the profits of the permanent establishment the expenses incurred for the purposes of the permanent establishment even if those expenses are incurred outside the country where the permanent establishment is situated.

(4) Paragraph 4 precludes the attribution of profits to a permanent establishment by reason of merely purchasing activities carried on by the permanent establishment for the enterprise.

(5) Paragraph 5 provides that unless there are good and sufficient reasons to the contrary the business profits attributed to a permanent establishment must be determined by the same method each year.

(6) Paragraph 6: refer to initial comments on this Article above.

(7) Paragraph 7 provides that income from the business of any form of insurance is not subject to the provisions of this Article. Such income may be taxed in accordance with the domestic law of each country.

Article 8 – Shipping and Air Transport

(1) Under this Article profits from operating ships or aircraft in "international traffic" – defined in Article 3(1)(e) are to be taxed only in the country of residence of the enterprise. International shipping and aircraft profits include income from:

(a) carriage of passengers and cargo;
(b) sale of passenger tickets on behalf of other enterprises;
(c) commercial advertising;
(d) charter fees (but refer paragraph (2) below).

Due to the definition of "international traffic", exemption does not extend to profits derived from coastal traffic. Further, investment income of shipping and air transport enterprises is subject to the treatment ordinarily applied to that class of income, e.g., dividends derived would be subject to Article 10.

(2) Paragraph 2 specifically brings within the scope of this Article profits arising from the rental of ships or aircraft or from the use, maintenance, or rental of containers and ancillary equipment provided:

(a) the ships, aircraft or containers are used in international traffic, and

(b) the enterprise receiving the profits is in the business of operating ships and aircraft in international traffic, and

(c) the rental income is incidental to the profits derived from those activities.

It follows that bare boat charter fees will be taxed only in the State of residence of the lessor provided the conditions set out in subparagraphs (a) to (c) above are met.

In the case of container leasing where the conditions in subparagraphs (a) to (c) are not met, the lease payments would come within the scope of Article 12 Royalties, i.e., payments for the use of commercial or scientific equipment.

This provision does not change current policy in relation to profits from leasing ships or aircraft on charter fully equipped, manned and used in international traffic. Such profits will continue to be treated as coming within the scope of paragraph 1 of the Article.

New Zealand does not normally include this paragraph in double tax treaties as we apply a liberal interpretation to paragraph 1 which has the same effect.

Article 9 – Associated Enterprises

This Article enables an arm's-length profit to be attributed to associated enterprises in accordance with the taxation laws of the State applying the Convention.

Article 10 – Dividends

(1) Paragraph 1 of the Article simply states that dividends may be taxed in the State of the recipient's residence.

(2) Paragraph 2 provides that the Contracting State from which the dividends are paid also has the right to tax, but the maximum tax that can be imposed is not to exceed 15 percent of the gross amount of the dividends. Therefore, in terms of the Convention New Zealand's taxing rights will be restricted to 15 percent of the gross dividend even though the rate under domestic law is 30 percent. In the case of New Zealand the limitation is to be achieved by withholding tax of 15 percent being deducted by companies paying the dividends to residents of the United States.

Although the rest of the Convention has effect from 1 April 1984, for the purposes of this Article paragraph 3 of Article 27 (Entry Into Force) is backdated to 1 April 1982 as the 1948 Agreement did not impose any rate restriction on New Zealand's taxation of dividends. Without this provision the rate of non-resident withholding tax on dividends paid to residents of the United States would have to have been 30 percent for the period 1 April 1982 to 31 March 1984 (refer Introduction).

(3) Paragraph 3 deals with dividends arising from shares which are attributable to a permanent establishment. It provides that in the State of source the dividends are taxable as part of the profits of the permanent establishment, **provided** they are paid in respect of holdings forming part of the assets of the permanent establishment or are otherwise attributable to that establishment. In effect this relieves the State of source of the dividends from the 15 percent limitation under the Article.

The rules set out above also apply where the recipient of the dividends has in the other State, for the purpose of performing any of the kinds of independent personal services mentioned in Article 14, a fixed base with which the holding in respect of which the dividends are paid is attributable.

Prior to 1 April 1982 these qualifications would have had no effect on the New Zealand tax position because our domestic law provided for a 15 percent final withholding tax in all cases on the gross payment and no convention can extend the taxing rights under domestic law. However, in view of the change in the New Zealand domestic law from 1 April 1982 the New Zealand tax on dividends paid in respect of shares attributable to a permanent establishment will be 30 percent.

(4) Paragraph 4 departs from the OECD model to the extent that it allows for example the United States to tax dividends paid by a New Zealand company to say an Austrian resident where the profits from which the dividend is paid are attributable to a permanent establishment in the United States and such profits make up at least 50 percent of the gross income from all sources of the company paying the dividend.

"Dividends" are not defined in the Convention, therefore the domestic law applies.

Article 11 – Interest

(1) Paragraph 1 affirms the taxing right of the State in which the recipient of the interest is a resident.

(2) Paragraph 2 also affirms the taxing right of the State in which the interest arises, but the maximum tax that can be imposed is not to exceed 10 percent of the gross amount of the interest. New Zealand's tax is therefore limited to 10 percent on gross interest paid to residents of the United States instead of the usual 15 percent.

(3) Paragraph 3 exempts interest which arises in New Zealand where the interest is:

(a) derived by the United States Government or an instrumentality of the United States Government which is not subject to tax in the United States; or

(b) derived by a resident of the United States the loans having been guaranteed or insured by the United States Government or an instrumentality of the United States Government which is not subject to tax on its income by the United States.

This provision is so worded that exemption would apply in similar circumstances to interest arising in the United States and derived by the New Zealand Government or New Zealand residents.

(4) Paragraph 4 provides that in the State of source interest is taxable as part of the profits of the permanent establishment there owned by a resident of the other State, **provided** the interest is paid in respect of debt-claims forming part of the assets of the permanent establishment or otherwise attributable to that establishment. In effect this paragraph relieves the State of source of the interest from any limitation under the Article.

The rules set out above also apply where the recipient of the interest has in the other State, for the purpose of performing any of the kinds of independent personal services mentioned in Article 14, a fixed base to which the debt-claim in respect of which the interest is paid is attributable.

These qualifications tie in with the New Zealand domestic law which provides that if a non-resident has a fixed establishment in New Zealand, then interest derived is not subject to non-resident withholding tax but is to be assessed on an annual basis. (Section 310 of the Income Tax Act 1976.)

(5) Paragraph 5 is a source rule and precludes argument as to the source of the interest.

The paragraph deals with interest arising through a permanent establishment or fixed base. Where a loan is contracted for the requirements of that establishment and the interest is borne by that establishment, the paragraph determines that the source of the interest is in the Contracting State in which the permanent establishment is situated, leaving aside the place of residence of the owner of that establishment or base.

(6) Paragraph 6 is an anti-avoidance provision to ensure that only a reasonable interest payment (e.g., arm's-length) is taxed at the reduced rate specified in the Convention.

(7) Paragraph 7 prevents either State from applying unacceptable source rules (colloquially known as "rogue source rules") to interest and imposing tax on that interest.

"Interest" is not defined in the Convention, therefore the domestic law applies.

Article 12 – Royalties

(1) Paragraph 1 affirms the taxing right of the State in which the recipient of the royalties is a resident.

(2) Paragraph 2 also affirms the taxing right of the State in which the royalties arise, but the maximum tax that can be imposed is not to exceed 10 percent of the gross amount of the royalties. New Zealand's tax is therefore limited to 10 percent on gross royalties paid to residents of the United States instead of the usual 15 percent withheld. In New Zealand the limitation will be achieved by the payer of the royalties deducting withholding tax of 10 percent at the time of payment. In the case of royalties which are subject to annual assessment the tax will be limited to 10 percent of the gross payment.

(3) Paragraph 3 defines "royalties" for the purposes of the Article. The term includes lump sum payments and certain rents. However, variable or fixed payments for the working of mineral deposits or other natural resources do not fall within the defined term as they are governed by Article 6.

It should be noted that if a payment is made in the form of rent rather than on a royalty basis and the payment comes within the term "royalties", as defined in the Convention, then the 10 percent maximum on gross applies. However, rental payments do not constitute royalties under our domestic law and there is, therefore, no non-resident withholding tax applicable. Payments of this nature will be subject to an annual assessment on the net amount after expenses and if the tax so levied exceeds 10 percent of the gross rental, a rebate will be given by virtue of the Convention to bring the tax down to 10 percent of gross.

Section 224 of the Income Tax Act 1976 provides for a special basis for calculating the income of non-resident film renters. This special basis is preserved in paragraph 2 of the Protocol.

(4) Paragraph 4 provides that in the State of source royalties are taxable as part of the profits of the permanent establishment there owned by the recipient which is a resident of the other State, **provided** the royalties are attributable to that establishment. In effect this relieves the State of source of the royalties from the 10 percent limitation under the Article.

The rules set out above also apply where the recipient of the royalties has in the other State, for the purpose of performing independent personal services, a fixed base to which royalties are attributable.

New Zealand's domestic law in relation to royalties provides for a withholding tax rate of 15 percent final on copyright (cultural) royalties or where the aggregate annual royalty payments do not exceed $1,000, while a minimum final tax applies in all other cases.

(5) Paragraph 5 is a source rule and precludes arguments as to the source of the royalties. Paragraph 5(b) was inserted at the request of the United States because of their domestic source rules for royalties and is known as the "use test".

This provision, for example, gives a royalty a source in the United States if a New Zealand company licences a trademark to a company in a third country. The third country company then markets the product in the United States without having a permanent establishment there. The payment for trademark between the third country and New Zealand has a source in the United States under the "use test" and the United States may tax but must limit the tax to 10 percent of the gross.

(6) Paragraph 6 is an anti-avoidance provision to ensure that only a reasonable royalty payment (arm's-length) is taxed at the reduced rate specified in the Convention.

Article 13 – Alienation of Property

(1) Paragraph 1 concerns income or gains derived from the alienation of **real** property. Income from such alienation may be taxed in the State where the property is situated. For example, if a resident of the United States sells at a profit real property situated in New Zealand the profit can be taxed in New Zealand if the New Zealand domestic law permits that taxation.

(2) Paragraph 2 defines "real property" for the purposes of the Article. In the case of New Zealand it includes:

(a) real property as defined in Article 6; and

(b) shares in a company the assets of which are principally real property situated in New Zealand;

(c) an interest in a partnership, trust or estate, the assets of which consist principally of real property situated in New Zealand.

The United States definition includes "real property interest" which is a term used in their domestic law in the taxing of foreign owned interest in real estate situated in the United States.

(3) Paragraph 3 provides that income or gains from the alienation of ships, aircraft or containers operated in international traffic are taxable only in the State of residence of the enterprise. An exception is where depreciation has been allowed in the other country. In this case the other country may add back the depreciation upon alienation of the property.

(4) Paragraph 4 ensures that income or gains from the alienation of royalties are taxed under Article 12 and subject to the limitation of 10 percent.

(5) Paragraph 5 deems the real property defined in 2(b)(ii) and 2(b)(iii) to be situated in New Zealand. This paragraph is necessary as the taxing of real property is dependent on situs under paragraph 1.

(6) Paragraph 6 deals with income or gains derived from the alienation of **personal** property forming part of the business property of a permanent establishment or pertaining to a fixed base used for the performing of independent personal services. These gains may be taxed in the State where the permanent establishment or fixed base is situated.

(7) Paragraph 7 stipulates that any income or gains from any property not covered by the Article is to be taxable only in the State of which the alienator is a resident.

Article 14 – Independent Personal Services

(1) This Article concerns income from personal services (i.e., independent personal services) as distinct from income from dependent personal services (e.g., remuneration such as salary or wages) which is dealt with separately under Article 15. Income from independent personal services is taxable only in the State of residence **unless** the services are performed in the other State and the recipient of the income:

- is present in the other State for a period or periods aggregating more than 183 days in any consecutive 12 month period; or
- has a fixed base regularly available to him in the other State for the purpose of performing his activities.

If either of the above exceptions applies the State in which the services are performed also has the right to tax the income therefrom.

The term "fixed base" is intended to cover a centre of activity of a fixed or permanent character, for instance a doctor's consulting room or the office of an architect or lawyer.

(2) The Article does not apply to artistes or athletes which are dealt with under Article 17.

(3) There is no article specifically dealing with Directors' Fees in this Convention. Director's fees paid by a New Zealand company to a United States resident director will be dealt with under Article 21.

Article 15 – Dependent Personal Services

(1) Paragraph 1 states the general rule that personal services performed by a resident of one of the Contracting States may be taxed in that other Contracting State, only if the services are performed in that other Contracting State.

(2) Paragraph 2 states the case where exemption will be given by the State visited. The main requirements are that:

- the recipient of the income is present in the State visited for a period or periods which do not exceed **in the aggregate** 183 days in any consecutive 12 month period; and
- the remuneration is paid by an employer not resident in that State; and
- the remuneration is not connected with the activities of a permanent establishment or fixed base which the employer has in that State.

Regarding the 183 day test the term "consecutive 12 month period" should be noted as the treatment effectively differs from the term "income year" which is used in other treaties.

Where the term "income year" is used for the purposes of the 183 day test each income year is looked at separately in determining the number of days present. Therefore the exemption could apply where a visit of more than 183 days straddles two income years provided the visit does not exceed 183 days in either year.

When applying the "consecutive 12 month period" criterion it should be remembered that each day means the commencement of a period of 12 months from that particular day. Thus, although a visit may straddle two income years the exemption will not apply if the visit exceeds 183 days over a period of 12 months. For example, a United States resident who visits New Zealand on 1 November and departs on the following 30 June will not be exempt as he will have been present in New Zealand for more than 183 days in a 12 month period.

In this example, if the criterion was an "income year" instead of "consecutive 12 month period" the visitor could be exempt as at no stage would he be present in New Zealand for more than 183 days in **an income year**.

When a visitor from the United States undertakes employment in New Zealand, New Zealand PAYE tax will be required to be deducted from the remuneration paid but will be refunded at the time of departure provided the requirements of the Article are fully met. In this respect a certificate must be obtained, by the person seeking exemption, from the United States authorities which certifies that that person is resident in the United States for the purposes of United States tax. It is not sufficient that a person is a **citizen** of the United States. (See comments on Article 4 (Residence).)

(3) Directors' fees: refer to paragraph 3 of Article 14 of this bulletin.

Article 16 – Limitation on Benefits

This Article is designed to limit the opportunity for third country residents to take advantage of the treaty benefits by organising a holding or investment company in one of the Contracting States.

(1) Paragraph 1 provides, for example, that for a company which is a resident of New Zealand (or person other than an individual) to obtain the benefit of the Convention the following conditions apply:

(a) The company must be at least 75 percent owned by:

(i) individuals who are residents of the United States;

(ii) citizens of the United States;

(iii) individuals who are residents of New Zealand;

(iv) companies whose shares are traded on a recognised stock exchange;

(v) the New Zealand or United States governments; OR

(b) The New Zealand company's shares are traded on a recognised stock exchange; OR

(c) The principal purpose of forming the New Zealand company was not of obtaining benefits under the Convention.

Example

A company which is a resident of New Zealand is deriving interest income from the United States. If the company is, say, 40 percent owned by persons resident in the Bahamas the 10 percent source limitation under Article 11 will not apply and the United States would be free to tax the income at source at domestic rates. The same would apply in the converse situation of a United States resident company deriving income from New Zealand and having more than 25 percent ownership by residents in a third (or tax haven) country.

(2) Paragraph 2 defines the term "a recognised stock exchange".

(3) Paragraph 3 denies the benefit of the Convention to trusts deriving income from schemes the principal purpose of which is to obtain benefits under the Convention, e.g., it will counter income splitting by, say, a New Zealand resident using United States trusts.

(4) Paragraph 4 provides for consultation between the competent authorities before this Article is applied.

Article 17 – Artistes and Athletes

(1) Paragraph 1 enables the State in which the entertainer or athlete is performing the services to tax the income derived from these personal activities if the gross receipts derived by him exceed US$10,000. It is important to note that expenses reimbursed to him or borne on behalf of him are to be included in the calculation of the threshhold of US$10,000.

Example

A United States resident entertainer visits New Zealand to participate in the TV Telethon. He receives a fee of US$6,000 and is reimbursed his air fare and accommodation expenses totalling US$5,000. In this case the gross receipts would exceed US$10,000 and the income of $6,000 would be subject to New Zealand tax.

(2) Paragraph 2 deals with the situation where income for the performance of an entertainer or athlete is not paid or paid in full to the entertainer or athlete himself but to an enterprise providing the services of the entertainer or athlete. The paragraph permits the State in which the performance is given to impose a tax on the profits diverted from the income of the entertainer or athlete to the enterprise where for instance the entertainer or athlete has control over or rights to the income thus diverted or has obtained or will obtain some benefit directly or indirectly from that income. Without this paragraph the State where the services are being performed would, in such cases, be unable to tax:

(a) because it would not be personal service income to the entertainer, and

(b) in the absence of a permanent establishment the payments could not be taxed as business profits in the hands of the other person.

The onus is on the entertainers or athletes to prove that they are not associated with the enterprise deriving the profits.

Article 18 – Pensions

(1) Paragraph 1(a) gives the State of **residence** exclusive right to tax pensions where they are paid in consideration of past employment. However, this Article does not cover Government pensions for services rendered which are dealt with in Article 19(2).

Paragraph 1(b) states that pensions and other payments made under the social security legislation are taxable only in the country paying them, i.e., State of source.

Example

A resident of New Zealand receives a pension from a previous employer who is a resident of the United States. He also receives a social security pension from the United States Government. The tax position is as follows:

(i) the pension from the United States employer will be subject to tax solely in New Zealand as the country of residence and will be exempt in the United States;

(ii) the pension from the United States Government will be taxed at source in the United States and will be exempt from tax in New Zealand.

(2) Paragraph 2 gives the State of residence exclusive right to tax annuities.

Article 19 – Government Service

This Article deals with remuneration paid to an individual in respect of services rendered to a State or political sub-division or local authority thereof.

(1) Paragraph 1 provides for two situations:

- Remuneration paid by a State in respect of services rendered to it by an individual shall be taxable only by that State, i.e., country of origin of the payment.
- However, such remuneration is taxable only in the country where the services are performed provided the services are performed:

  (i) by an individual who is a resident and also a citizen of that country, or

  (ii) by an individual who is a resident of that country and did not become a resident of that country solely for the purpose of performing those services.

The second situation can be illustrated as follows.

Remuneration paid by the United States for services rendered in New Zealand by an individual who is a resident and citizen of New Zealand shall be taxed exclusively in New Zealand. This is still the position even though the individual, although a citizen of New Zealand, did become a resident of New Zealand for the purposes of rendering those services for the United States Government.

Example

A locally recruited employee performing services for the United States Government in New Zealand, such as an individual who is a resident of New Zealand, will be liable for New Zealand tax on the employment income even though he may be a citizen of the United States.

(2) Paragraph 2 provides that Government pensions for services rendered are taxed exclusively in the State of source **but** if the recipient is a resident **and** a citizen of the other State, the pensions are taxable on a residence basis. This means that a United States pension paid to a resident of New Zealand is taxed only in the United States and exempt in New Zealand unless the recipient is also a citizen of New Zealand in which case the pension is taxed only in New Zealand and exempt in the United States.

(3) Paragraphs 1 and 2 do not apply if the services are performed in connection with business carried on by the State, or one of its political subdivisions or local authorities, paying the remuneration. Under paragraph 3 the ordinary rules apply: Article 15 for wages and salaries; Article 18 for pensions and annuities.

Article 20 – Students

This Article exempts from New Zealand tax maintenance, education or training payments received here from overseas by a student from the United States. Note:

- The student must have been a resident of the United States immediately before he comes to New Zealand.
- He must be in New Zealand for the purpose of his education or training.
- The payments must be made from sources outside New Zealand.
- There is no time limit on the period spent in New Zealand.
- The exemption is restricted to the payments mentioned, i.e., for maintenance.

The converse applies to a New Zealand student going to the United States.

Article 21 – Other Income

(1) This Article provides a general rule relating to income not dealt with in the other Articles of the Convention. The income concerned is not only income of a class not expressly dealt with but also income from sources not expressly mentioned. A secondary effect of the Article is to clarify the situation of income derived from a third country by a person who could be "resident in" both the United States and New Zealand under the general laws of each country. Under the Convention that person can be a "resident of" only one country. In such a situation the taxing rights as to the third country income are allocated to the country "of" which he is a resident for the purposes of the Convention.

(2) The effect of the Article is that income derived by a resident of New Zealand is taxed exclusively in New Zealand unless the income is derived from sources in the United States. If the income is derived from sources in the United States it may also be taxed there and a credit for the United States tax is given in New Zealand, should that income be liable for New Zealand tax. The converse will apply in the case of a resident of the United States. Cases of conflict as to residence are to be determined by reference to Article 4.

Example

A "resident of New Zealand" who is also a United States citizen derives dividends income from Australia. The United States, although it normally taxes the world income of its citizens, will have to exempt the Australian dividends by virtue of Article 21. New Zealand, as the country of residence will tax the dividends and allow credit for any tax paid in Australia.

Article 22 – Methods of Elimination of Double Taxation

(1) This Article contains the rules whereby each State gives credit for the other State's tax when assessing its residents on income derived from sources in the other State. It should be noted that the credit provisions in the Article are subject to the domestic law of each country.

(2) Paragraph 3 covers the position of a United States citizen or United States company which is also a resident of New Zealand. The paragraph provides that where a resident of New Zealand derives income from the United States then New Zealand will allow credit for United States tax deducted at source in accordance with the provisions of the Convention. The United States, in taxing its citizens on an annual assessment basis, will credit against any additional United States tax the New Zealand tax assessed less the New Zealand tax credit allowed. (See example below.)

(3) Paragraph 4 is a source rule **for the purposes of the Article** in order to solve any dual source cases which may arise thus facilitating the allowance of a tax credit.

(4) The taxation by the United States on a "citizen" basis rather than a "resident" basis as explained in the notes on Article 1 has complicated the wording of this Article. The following examples may assist:

Example 22/1

(i) United States citizen living in New Zealand for, say, 5 years. The United States authorities accept that he is a "resident of New Zealand" under Article 4.

(ii) Receives business profits from the United States but has **no permanent establishment** in the United States.

(iii) Under Article 7 of the agreement the income is taxable only in New Zealand, however the United States has a residual right to tax under Article 1(3) but must give credit for the New Zealand tax paid under Article 22 by virtue of Article 1(4).

Example 22/2

(i) The same facts as Example 22/1(i).

(ii) Receives the following items of income:

(a) Income of $30,000 from personal services performed in New Zealand.

(b) Dividends from a United States company of $1,000 from which $150 in tax has been withheld by the United States Internal Revenue Service.

(c) Rental income of $2,000 from a house situated in the United States.

(iii) (a) Under Article 15 New Zealand may tax the personal service income of $30,000. The United States taxes the income under its domestic law but, in certain circumstances, allows an exemption for foreign earned income of its citizens. In the absence of such exemption, New Zealand does not allow a credit for any United States tax imposed as the income has a New Zealand source.

(b) Under Article 10 New Zealand may tax the dividends but must allow credit under Article 22 for the $150 tax at source which the United States may impose under paragraph 2 of Article 10. The United States has a residual right to tax under paragraph 3 of Article 1 ('savings clause') but must give credit for the New Zealand tax paid (paragraph 3 of Article 22). New Zealand does not allow credit for any residual tax imposed by the United States.

(c) Rental income derived from real property situated in the United States is taxed in New Zealand by virtue of our domestic law concerning residence. Under Article 6 the income may also be taxed in the United States. In this case New Zealand allows credit under Article 22 for tax paid in the United States.

Article 23 – Non-Discrimination

(1) Paragraph 1 establishes the principle that for purposes of taxation discrimination on the grounds of citizenship is forbidden. The last sentence of the paragraph is a United States provision protecting the taxation liabilities and benefits attached to United States citizens living outside the United States as distinct from non-United States citizens living outside United States. This is because United States citizens are taxed on their world income by the United States wherever they reside.

(2) Paragraph 2 requires non-residents trading through a permanent establishment to be taxed no less favourably than a resident who carries on the same activities.

Despite this provision New Zealand may for example continue to:

(a) grant to New Zealand residents special exemptions and rebates which do not extend to non-residents;

(b) impose the higher non-resident company tax rate on the profits of a permanent establishment in New Zealand;

(c) impose non-resident withholding tax on dividends paid by a New Zealand company to a United States company.

(3) Paragraph 3 is designed to end a particular form of discrimination resulting from the fact that in certain countries the deduction of interest, royalties and other disbursements allowed without restriction when the recipient is resident, is restricted or even prohibited when he is a non-resident. New Zealand does not discriminate in this area between residents and non-residents.

(4) Paragraph 4 prevents discrimination against enterprises which are wholly or partly owned by residents of the other country, e.g., a New Zealand subsidiary of a United States company. This has no practical effect in New Zealand – we do not discriminate against such enterprises.

(5) Paragraph 5 provides that this Article shall not apply to any provision in taxation laws which:

(a) is reasonably designed to prevent or defeat the avoidance or evasion of taxes; **or**

(b) is in force in the United States and New Zealand at present and any subsequent laws which have substantially similar purpose or intent.

Provided that for example New Zealand does not give greater benefits to residents or citizens of third countries than to residents or citizens of the United States.

(6) Paragraph 6 states that each country may distinguish between residents and non-residents. The paragraph makes it clear that the Article does not prevent different tax treatment solely on the basis of residence. This is the New Zealand view in any case.

(7) Paragraph 7 provides that where either State changes its taxation laws and the other State considers that those laws infringe the principles set out in the Article then the competent authorities consult in an endeavour to resolve the matter.

Article 24 – Mutual Agreement Procedure
Article 25 – Exchange of Information

These are standard Articles requiring no further comment.

Article 26 – Diplomatic Agents and Consular Officers

The aim of this Article is to ensure that diplomatic agents or consular officers shall, under the Convention, receive no less favourable treatment than that to which they are entitled under international law or under special international agreements.

Article 27 – Entry Into Force

The Convention came into force on 2 November 1983 with effect in New Zealand:

(a) for any income year beginning on or after 1 April 1984.

(b) from 1 April 1982 in the case of dividends beneficially owned by a resident of the United States.

In the United States it takes effect:

(a) on 1 January 1983 in respect of taxes withheld at source.

(b) for taxable years beginning on or after 1 January 1983.

There is no need for transitional provisions in this Convention as the 1948 Agreement ceases to apply when the provisions of the 1982 Convention take effect.

Article 28 – Termination

This Article sets out the procedure if either State wishes to terminate the Convention. Unless notice of termination is given in accordance with the Article the Convention continues indefinitely.

Protocol

The Protocol which forms an integral part of the Convention contains additional provisions in relation to certain Articles of the Convention.

(1) Paragraph 1 provides that if New Zealand agrees to lower rates for dividends, interest and royalties in future double taxation conventions then New Zealand will inform the United States and renegotiate.

(2) Paragraph 2 provides for the preservation of the special basis of taxation of non-resident film renters under section 224 of the Income Tax Act 1976.

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