

## **Commissioner's Statement CS 20/03**

### **NRWT for dividends paid to companies: Administering the new holding period tests in Article 10 of the NZ/Australia DTA (and in agreements with other countries)**

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***The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter. The Statement is not a consultative document.***

All legislative references are to the Income Tax Act 2007 (the Act) unless stated otherwise.

#### **Summary**

1. Article 10 of the New Zealand-Australia double tax agreement (the DTA) allows for different rates of non-resident withholding tax (NRWT) to be applied to dividends paid to a company. For a corporate payee, the applicable rate is reduced to five percent or zero percent if the payee holds more than a certain percentage of the voting shares in the payer. Previously, for the zero percent rate, the voting shares had to be held for a specified period (the holding period) prior to the date of declaration of a dividend.
2. With effect from 1 January 2019, Article 8(1) of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the MLI) changed the operation of the holding period requirement that must be met for dividends paid to a corporate payee to qualify for the lower rates. The effect of this change is to introduce a holding period requirement before being able to use the five percent rate and that the holding period requirement for both the five and zero percent rates can be met having regard to share ownership after a dividend is paid as well as before.
3. If a shareholder has not satisfied the holding period requirement when a dividend is paid, but may satisfy the requirement in the future, the question arises as to whether a dividend paid to that shareholder should have NRWT withheld from it at a lower treaty rate of five percent or zero percent or at the ordinary treaty rate of 15 percent, with Inland Revenue providing a refund to bring the NRWT down to five or zero percent once the requirement has been met.
4. The Commissioner's view of the correct practice is that NRWT must be withheld from the dividend at the 15 percent rate, and a refund sought once the test has been satisfied.
5. Where a corporate shareholder has already held the specified percentage of voting shares for 365 days when a dividend is paid, as was the case before the modification by the MLI, the dividend payer may deduct at the appropriate lower rate.

6. These provisions only apply to corporate payees; individuals are not affected by this specific modification made by the MLI.
7. The position outlined in this Statement for the DTA also applies for agreements with other countries where the holding period tests in the MLI apply.

### **Background**

8. The withholding tax provisions in New Zealand's current double tax agreement with Australia (the DTA) came into force on 1 May 2010.
9. Article 10 of the DTA concerns the rates of non-resident withholding tax (NRWT) on trans-Tasman dividends. The treaty provides for the following rates of NRWT:
  - (a) The ordinary treaty rate is 15 percent (Article 10(2)(b));
  - (b) If a shareholder is a company and holds at least ten percent of the voting power in the company paying the dividends, then the applicable rate is five percent (Article 10(2)(a)); and
  - (c) If a shareholder is a company and holds at least 80 percent of the voting power in the company paying the dividends and has held that stake for at least a 12-month period ending on the date that the dividend is declared, then no NRWT would need to be withheld so the applicable rate is effectively zero percent (Article 10(3)).
10. To be eligible for the zero rate of NRWT on dividends in Article 10(3), the holding period test described in paragraph (c) above must be satisfied. Because the test requires the dividend payer to look backward only from the date of the dividend declaration ("ending on the date"), whether or not a shareholder meets the test or not will have a definitive answer when the dividend is paid. Allowing self-assessment in this instance is not a problem.

### **Modification**

11. The *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Multilateral Instrument or MLI) came into effect for the DTA for withholding taxes on 1 January 2019.
12. Article 8(1) of the MLI pertains to dividends and, given that New Zealand has agreed with Australia to be covered by this Article, introduces a minimum holding period to Article 10(2)(a) of the DTA and modifies the minimum holding period in Article 10(3).
13. The new language for this test following New Zealand and Australia agreeing for Article 10 of the DTA to be covered by Article 8 of the MLI requires the ownership threshold to be met "throughout a 365 day period that includes the day of the payment of the dividends". If a shareholder purchases shares on a given day, is paid a dividend from those shares six months after purchasing them, and then

holds the shares for another six months, the shareholder may be eligible for one of the lower treaty rates in Article 10(2)(a) or Article 10(3) of the DTA. The shareholder would have held the shares for a 365-day period that “includes the day of the payment of the dividends”, despite the fact that the shareholder had not held the shares for 365 days when the dividend was paid.

14. The situation described in the previous paragraph creates a new question for the payer; should they use an NRWT rate consistent with the eligibility criteria that the shareholder may meet or intends to meet in future but does not meet at the time of the dividend payment, or should they use an NRWT rate consistent with what the shareholder is eligible for at the time of the dividend payment before seeking a refund once they are eligible for a lower rate?

### **Refund approach**

15. The Commissioner’s position is that dividend payers in this situation should withhold at the ordinary treaty rate of 15 percent. The payer (or alternatively the payee) can then seek a refund under section RM 8 once the shareholder has satisfied that minimum holding period. If obtained by the dividend payer, this refund can be passed on to the shareholder.
16. The Commissioner considers that payers being required to withhold at 15 percent is the correct legal position in these circumstances. A shareholder who has not met the holding period requirements at the time a dividend was paid does not satisfy the wording of the tests in Article 10 of the DTA as modified or limited by Article 8 of the MLI and so is not eligible for either of the lower rates that require satisfaction of the holding period. The shareholder’s expectation that they will satisfy the holding period in future does not override the fact that the shareholding requirements for the lower rates have not been met at the time the dividend is paid.
17. It is also the correct position in terms of policy. The alternative approach in this situation would be to allow, from the start, a payer of a dividend to select a lower treaty rate from the time the dividend is paid. A number of issues have been identified with this anticipatory approach:
  - (a) If a payer anticipates the shareholder meeting the minimum holding period test in future and therefore self-assesses at a lower rate in the meantime, but ultimately the shareholder ends up disposing of those shares and never meeting the test, then they or the shareholder would need to make an active decision to pay to the Commissioner the tax owing. This creates a risk of non-compliance, which partly defeats the withholding aspect of NRWT.
  - (b) Following on from paragraph (a) above, collecting the money owed (which may be relatively insignificant in itself) may be difficult. The Commissioner would likely seek the underpaid tax from the dividend payer in the first instance, since the shareholder is not in New Zealand. The payer would have a right of indemnity against the shareholder as the beneficial owner of the dividend, but this might be difficult to enforce.

- (c) The payer is the withholder but will not control and may not know the intentions of the payee (the shareholder). This is particularly problematic for payers applying Article 10(2)(a), where a lower treaty rate may be claimed with a shareholding as low as ten percent – for owners of relatively low proportions of total shareholdings, the company is unlikely to know as much about the shareholder’s intentions about holding the shares.
  - (d) Following on from paragraph (c) above, it is clear that allowing self-assessment would be relatively costly for the purposes of administering Article 10(2)(a). Although it is less of a concern for Article 10(3) (which requires a shareholding of at least 80 percent), it would be preferable to have the same administrative approach for both Article 10(2)(a) and Article 10(3).
18. The Australian Tax Office has put out guidance on its website<sup>1</sup> which states that payers of dividends must withhold at the ordinary treaty rate if the test has not been met by a payee at the time a dividend is paid. If the holding period is subsequently satisfied at a point in time after the dividend payment, the beneficial owner of the dividend (or a representative) may apply for a refund of the amount over-withheld. For consistency in the application of the DTA, it is preferable for New Zealand to take the same approach as Australia does on this issue.
19. Companies in this situation may receive a tax credit for foreign income tax paid at the 15 percent rate of NRWT. If a shareholder (either directly or via the payer) is refunded NRWT upon satisfying the holding period test so that they have only paid five percent or zero percent NRWT, then section LJ 7(2) states that their tax credit claim will need to be adjusted accordingly if that credit has been claimed at 15 percent.
20. If the credit is claimed after the shareholder has assessed their tax liability, section LJ 7(3) states that the shareholder is liable to pay the Commissioner the lesser of the amount of the refund or the amount of New Zealand tax payable on the dividend income.

### **Examples**

21. Example 1 sets out a situation in which a taxpayer would need to engage in the refund process in relation to applying a lower treaty rate when they have not yet met the minimum holding period requirement:

#### **Example 1**

AusCo, an Australian corporate resident, purchases 80,000 shares in NZCo, a company that is resident in New Zealand. This purchase represents 80 percent of the voting rights in NZCo and occurs on 30 September 2018. On 31 March 2019, NZCo pays a dividend to its shareholders of 10c per share, which entitles AusCo to an \$8,000 dividend. AusCo intends to hold the shares for at least another year, which means it will satisfy the minimum

<sup>1</sup> <https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Australian-income-of-foreign-residents/Straddle-holding-period-rule/>

holding period in the future. However, at the time the dividend has been paid, AusCo has only held the shares for six months and therefore has not met the minimum holding period test on the date of payment. NZCo must deduct NRWT at the ordinary treaty rate of 15 percent on 31 March 2019, equal to \$1,200.

On 30 September 2019, AusCo has held the shares for 365 days. Based on its ownership rights in NZCo, AusCo will now be eligible for the reduced rate of NRWT of zero percent as set out in Article 10(3). NZCo will need to seek a refund with respect to the NRWT on the March 2019 dividend by completing an IR 386 form to receive the difference between the 15 percent NRWT that it originally paid and the zero percent NRWT that is ultimately liable. Having originally paid 15 percent NRWT equal to \$1,200, NZCo receives that full amount as a refund and passes it on to AusCo.

22. The position set out in this Statement does not affect the requirements of any taxpayer who has held a number of shares for at least 365 days when a dividend is paid since they will already be eligible for either of the lower rates. This is illustrated in Example 2:

### Example 2

AusCorp, an Australian corporate resident, purchases 1,000 shares in NZCorp, a company that is resident in New Zealand. This purchase represents ten percent of the voting rights in NZCorp and occurs on 31 March 2019. On 31 March 2020, NZCorp pays a dividend to its shareholders of 20c per share, which entitles AusCorp to a \$200 dividend. Because AusCorp has held the shares for 365 days by the time the dividend has been paid (and based on its ownership rights in NZCorp), it is eligible for the reduced rate of NRWT of five percent as set out in Article 10(2)(a). NZCorp pays \$10 in tax and does not have to engage in the refund process since AusCorp met the minimum holding period test when the dividend was paid.

### Application to dividends paid to shareholders in countries other than Australia

23. At the time of writing, New Zealand has agreed to be covered by Article 8 of the MLI with both Mexico and Canada as well. Further, although New Zealand does not have an agreement with China to be covered by Article 8 of the MLI, the MLI's definition of the minimum holding period has been written directly into the New Zealand-China DTA that came into force in 2019. The same approach will be taken with these countries as outlined in this Commissioner's Statement.

### General

24. This Statement provides general guidance to assist taxpayers in meeting their taxpayer obligations. If you have any concerns about compliance with the tax

obligations discussed in this Commissioner's Statement, you should discuss the matter with a tax professional or Inland Revenue.

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