Inland Revenue
Te Tari Taake

FACT SHEET | PUKA MEKA

# Tax residence – companies

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IS 25/16 FS 2

This fact sheet accompanies IS 25/16: **Tax residence** and summarises the tax residence rules in the Income Tax Act 2007 relating to companies. The interpretation statement explains the rules for companies, individuals and trusts in more detail. There are also fact sheets covering tax residence of individuals and trusts.

## Key provisions | Whakaratonga tāpua

**Section YD 2** of the Income Tax Act 2007 sets out the tax residence rules for companies.

## Key terms | Kīanga tau tāpua

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| **centre of management test** | A company is a New Zealand tax resident if its centre of management is in New Zealand.<br>The focus of the test is on the centre of management of the company as a whole, and as a matter of fact (that is, it is not limited to formal management structures and governance documents). |
| **director control test** | A company is a New Zealand tax resident if its 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. |

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| | If there are directors both in New Zealand and overseas, often a simple majority approach is appropriate in testing whether control of the company is exercised from New Zealand. But this is not always the case (see from [21]).<br><br>The definition of "director" for this test is broad, to ensure that *de facto* directors are included and that entities without directors (such as unit trusts) are covered by the test.<br><br>This test focuses on where the directors exercise their directorial control of the company as a whole from – that is, the place from which the strategic and policy decisions are made, on a continuing basis. |
| **head office test** | A company is a New Zealand tax resident if its head office is in New Zealand.<br><br>A company's head office is the office, which must be a physical place (for example, a building), from which the company's business is directed and carried on. |
| **place of incorporation test** | A company is a New Zealand tax resident if it is incorporated in New Zealand.<br><br>This includes any company incorporated under the Companies Act 1993. |

# Introduction | Whakataki

1. The concept of tax residence is a central feature of the Income Tax Act 2007 and the Goods and Services Tax Act 1985.

2. The main relevance of tax residence for income tax purposes is that it determines whether a person is assessable for tax on worldwide income or on only New Zealand-sourced income. This is because:

   - New Zealand residents are assessable on worldwide income[1] (though they may be entitled to a credit for foreign tax paid on foreign-sourced income or gains); and
   - non-residents are assessable only on New Zealand–sourced income.

[1] Other than exempt income and excluded income.

# Tax residence rules for companies

## Overview of the domestic tax residence rules for companies

3. A company is a New Zealand tax resident if:
   - it is incorporated in New Zealand;
   - its head office is in New Zealand;
   - its centre of management is in New Zealand; or
   - its 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.
4. The definition of "company" goes beyond just a body corporate. For example, the definition includes a unit trust, and it extends to any entity with a legal existence separate from that of its members. This means it includes a wide variety of entities established under the laws of other countries that, although not companies in the strict sense, are equivalent to companies.

### The place of incorporation test

5. The first tax residence test is that a company is a New Zealand tax resident if it is incorporated in New Zealand.
6. This includes any company incorporated under the Companies Act 1993. Entities within the extended definition of company that are not capable of being incorporated, cannot be tax resident in New Zealand under this test (for example, a unit trust, for which there is no incorporation procedure in New Zealand).

### The head office test

7. The second tax residence test is that a company is a New Zealand tax resident if its head office is in New Zealand.
8. The head office of a company is the office that is above all others – the place of administration and management that is superior to all others. It is the office, which must be a physical place (for example, a building), from which the business of the company is directed and carried on.

9. Relevant consideration in determining which office is the head office include the location of senior management staff, and where major strategic and policy decisions are made.

## The centre of management test

10. The third tax residence test is that a company is a New Zealand tax resident if its centre of management is in New Zealand.

11. The focus of the test is on the centre of management of the company as a whole. Acts of management at various levels may be relevant.

12. The focus is on where the company's centre of management is as a matter of fact. The test is not limited to consideration of the company's formal management structures, such as those set out in corporate governance documents. What is relevant is how the company is managed in reality, even if that conflicts with governance documents or formal structures.

## The director control test

13. The final tax residence test is that a company is a New Zealand tax resident if its 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.

14. The definition of "director" for this test is broad, to ensure that *de facto* directors are included and that entities without directors (such as unit trusts) are covered by the test. The definition includes the following:

    - A person who occupies the position of director (that is, carries out the duties of a director), whether or not that title is used.
    - A person whose directions or instructions those occupying the position of directors are accustomed to acting in accordance with. The directions or instructions do not need to be direct – eg, this could be through a chain of companies.
    - A person who acts in the same way or a similar way as a director would act – that is, someone who is involved in making the types of decisions a director of a company would normally make. This ensures the test covers entities that do not have directors in the conventional sense (for example, a unit trust's manager is a director for the test).

15. The director control test focuses on where the directors exercise their directorial control of the company as a whole from – that is, the place from which strategic and policy decisions are made.

16. The significance of the location of directors' meetings (or the location from which directors attend the meetings, if they attend online) varies. If directors exercise control only during directors' meetings, the location of those meetings (or the location from which directors attend) is of paramount importance. But if control is exercised outside of directors' meetings, and the meetings are merely to formalise decisions that have already been made, the location of the meetings (or the location from which directors attend) is of little significance.

17. The fact directors exercise directorial functions from New Zealand does not necessarily mean control of the company by its directors is exercised from New Zealand. For example, if the directors ordinarily exercise their powers in Australia, the fact they occasionally travel to New Zealand and make directorial decisions from here does not mean the directors are exercising control of the company from New Zealand.

18. If the nominated directors do not exercise control of a company, but rather *de facto* directors exercise control from New Zealand, the company is resident in New Zealand even though the *de facto* directors are not directors under the company's constitution.

19. Determining whether the nominated directors exercise true control requires consideration of how the company as a whole is controlled in reality.

20. If nominated directors are accustomed to act in accordance with the directions or instructions of another person, this does not necessarily mean they are not exercising true control of the company. For example, they may exercise their independent minds in undertaking their directorial functions, not simply "rubber stamp" the decisions of others. However, it means the person in accordance with whose directions or instructions they are accustomed to act is also a director.

21. Decision-making by directors does not need to be confined to New Zealand for a company to be tax resident under this test. If directorial decision-making is exercised both in New Zealand and overseas, it is necessary to consider whether the functions performed in New Zealand amount to exercise of control of the company from New Zealand. In some cases, a simple majority approach is appropriate. For example, if two directors undertake their directorial functions only from Australia and three directors undertake their directorial functions only from New Zealand, and the powers of all directors are equal, a simple majority approach is appropriate, and the company is tax resident in New Zealand under the director control test. However, a simple majority approach is not appropriate in all situations – for example, if a director has exclusive special powers enabling them to control the company.

22. The director control test is satisfied if the directors exercise control of a company from New Zealand on a continuing basis. If control is ordinarily exercised from New Zealand, but is occasionally exercised from outside New Zealand, the company is tax resident in New Zealand on the basis that the directors exercise control from here.

## Changes in company tax residence

23. Some of the more significant income tax consequences that may arise when the tax residence of a company changes between New Zealand and another country are as follows:

- Under the company migration rules, a company that ceases to be a New Zealand tax resident is treated for tax purposes as if it had disposed of its property at market value, liquidated, and distributed the full amount available for distribution as dividends.
- As tax residents are assessable for income tax on foreign-sourced income, a change in tax residence means the foreign-sourced income a company derived while it was tax resident in New Zealand must be calculated (or a reasonable apportionment of the total foreign-sourced income made between the periods of residence and non-residence).
- The company may become required to establish and maintain an imputation credit account or may lose the right to maintain one – with associated consequences.
- There may be implications in relation to the controlled foreign company regime, the foreign investment fund regime, the financial arrangements rules, the grouping of some losses, and provisional tax.

## If a company is tax resident in more than one country

24. A company may be tax resident in both New Zealand and in another country under the domestic tax laws of each country. Dual residence has several implications in relation to the application of the Income Tax Act 2007 and New Zealand's double tax agreements (DTAs). These are discussed in IS 25/16.

25. If there is a DTA between New Zealand and the other country, it generally allocates tax residence to one of the countries for the purposes of the DTA. In determining the treatment of income covered by the DTA, the company is treated as being tax resident only in the country to which tax residence has been allocated. This gives that country the primary taxing right, so reduces the incidence of double taxation.

26. DTAs may be modified by the BEPS Multilateral Instrument (the MLI),[2] so the specific DTA and the countries' MLI positions must be considered to determine the allocation of tax residence for DTA purposes.

### Potential for dual residence if persons involved with a company migrate to or operate from another country

27. There is the potential for dual residence to arise if persons involved with a company (eg, directors) migrate to another country or operate from another country for an extended period. This may be the case whether or not there are trading operations or investments in the other country.

28. This is particularly important to bear in mind if persons involved with a company are considering migrating to or regularly operating from Australia – given the close relationship between Australia and New Zealand and the ease of migration and travel between the countries.

29. Tax advice should be sought prior to any person involved with a company migrating to another country or operating from another country for any extended period, to ensure there are no unintended tax consequences.

### Residence of foreign companies for the international rules

30. There are specific rules about where foreign companies are treated as being tax resident for the purposes of the international tax rules (which are defined in s YA 1 as including the rules relating to controlled foreign companies, foreign investment funds and foreign tax credits). These tax residence rules are set out in IS 25/16.

## About this document | Mō tēnei tuhinga

Some of the Tax Counsel Office's longer or more complex items are accompanied by a fact sheet that summarises and explains an item's main points. While it summarises the Commissioner's considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further Status of Commissioner's advice (Commissioner's statement, Inland Revenue, December 2012).

[2] *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD, ratified by New Zealand on 27 June 2018 and in force for New Zealand 1 October 2018).