

**APPENDIX D TO TIB NO. 11, JUNE 1990  
INCOME TAX (WITHHOLDING PAYMENTS) REGULATIONS 1979**

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## 1.0 INTRODUCTION

- 1.1 Amendment No 8 to the Income Tax (Withholding Payments) Regulations 1979 inserted a new sub-paragraph (ab) into the definition of “contract activity”.
- 1.2 The purpose of this item is to provide a background to the recent amendment, a description of the amendment and an explanation of the effects and extent of the regulations subsequent to the amendment.
- 1.3 Please note that this item is concerned only with Non-Resident Contractors’ Withholding Tax, and not to Non-Resident Withholding Tax. Non-Resident Withholding Tax applies only to payments of interest, dividends and royalties.

## 2.0 BACKGROUND

- 2.1 Non-Resident contractors are liable to income tax in New Zealand on any income they derive in New Zealand from any business or contract wholly or partly performed in New Zealand. This liability arises through the operation of sections 242(b), 243(2)(a), (o) and (pa) of the Income Tax Act 1976.
- 2.2 The numbers of Non-Resident Contractors performing services in New Zealand increased substantially during the late seventies-Early eighties with the introduction of the Government’s “Think Big” projects.
- 2.3 In response to this increase, the Non-Resident Contractors Withholding Tax Regime was introduced with effect from January 1982. The Regulations focused principally on activities associated with large construction related projects, (hence the definition of “contract project” in the regulations) and to a lesser extent, on the provision of equipment and personnel.

## 3.0 REASON FOR AMENDMENT

- 3.1 A Non-Resident contractor’s liability to withholding tax on contract payments received is determined by reference to the nature and type of contract carried on in New Zealand by the contractor.
- 3.2 The nature and types of contracts subject to the withholding tax regulations are contained in the definition of “contract activity”.

“Contract Activity” is defined (prior to amendment) in the regulations as:

“...in relation to any non-resident contractor means -

- (a) The performing or rendering of any work or contract service in New Zealand, being work or a contract service in connection with, or in relation to, any contract project:
  - (b) The granting, providing, or supplying of the use, or the right to use, in New Zealand (whether or not in connection with or in relation to any contract project), any personal property or any services of any person, being a person other than the non resident contractor:”
- 3.3 The numbers of Non-Resident Contractors coming to New Zealand in connection with “Think Big” type projects have steadily declined over recent years. However, the numbers of advisory, consultancy, or technical service contracts now being performed in New Zealand have markedly increased.
  - 3.4 Contract payments made in respect of these types of contracts were not covered by the regulations. Government was concerned that a repeat of the problems encountered prior to the introduction of the Non-Resident Contractors regime may occur.
  - 3.5 Also of concern was the fact that the regulations only targeted those Non-Resident Contractors performing services in connection with construction, installation, assembly or similar projects.
  - 3.6 The types and nature of contracts being performed in New Zealand by Non-Resident Contractors have changed significantly since the introduction of the Non-Resident Contractors Withholding Tax regime in 1982. It was therefore considered equitable that the regulations apply to all contracts being performed in New Zealand by Non-Resident Contractors.
  - 3.7 To achieve this, the definition of “Contract Activity” was amended to widen the scope of its application, ie the nature and types of contracts covered by the regulations were extended.

## 4.0 AMENDMENT

- 4.1 The definition of “Contract Activity” has been amended to include all contracts for service undertaken in New Zealand by Non-Resident Contractors. The amendment inserts a new sub-paragraph (ab) into the definition of “Contract Activity”.

The new sub-paragraph (ab) states:

“The performing or rendering of any work or contract service in New Zealand, whether or not that work or contract service is carried on or carried out in connection with, or in relation to, any contract project.”

- 4.2 This amendment ensures that any non-resident person who undertakes any contract for service in New Zealand will now be subject to the withholding payments regulations.
- 4.3 The types of contracts, envisaged by the amendment, will generally be distinguishable in that the major component of the contract will be advisory, consultancy or technical services. To date the more common types of contracts of this nature encountered by the Department have been concerned with computers, electronics, engineering, finance, management, marketing and property.
- 4.4 Contracts solely for the supply of goods, contracts of service (employment) and contracts for service the payments under which are deemed to be royalties in terms of paragraph (f) of the definition of “Royalty” in section 2 of the Income Tax Act continue to remain outside the scope of the regulations.
- 4.5 Sub-paragraph (ab) took effect from 22 March 1990 and applies to all payments made on or after that date, regardless of the date the contract was entered into. The rate of withholding tax applicable to contract payments made to Non-Resident Contractors remains unchanged at 15 percent on the gross contract payments.

## 5.0 EXAMPLES

5.1 The examples that follow are intended to demonstrate the scope of the withholding payments regulations as amended only. They are not intended to provide a complete discussion of the contractors’ New Zealand income tax liability.

- 1) A non-resident person, specialising in computer payroll accounting, undertakes a five month contract in New Zealand writing a computer programme for a New Zealand company. The non-resident person is in business in their own right as a computer software consultant.

**Q** Do the regulations apply to this contract?

**A** Yes. The contract undertaken in New Zealand comes within sub-paragraph

(ab) of the definition “contract activity”. The non-resident person therefore comes within the definition of a “non-resident contractor”.

- 2) A non-resident person comes to New Zealand for a working holiday. The person contracts to a company that carries on a cleaning business to clean offices. The person remains non-resident at all times during the visit to New Zealand.

**Q** Do the regulations apply to this contract?

**A** Yes, assuming the contract is a contract for service, ie not a contract of employment. However, in this case, whilst the contract with the cleaning company comes within sub-paragraph (ab) of the definition “contract activity” and the contractor meets the definition of a “Non Resident Contractor”, the non-resident provisions clash directly with clause 6 of Part A of the schedule to the regulations.

In cases such as this the appropriate rate set down in the specific clause is to be used. In this example, the rate applicable to the class of payments specified in clause 6 of Part A would apply. See paragraph 6 for further commentary.

- 3) A large New Zealand Corporate engages a firm of non-resident consultants to undertake a restructuring review of its establishment. The firm sends a team of four people to New Zealand to undertake the review. The New Zealand team are to report back to their overseas principal on completion of the review. Whilst in New Zealand, the salaries of the team continue to be paid by the overseas firm. It is anticipated the review will take two months to complete.

**Q** Do the regulations apply to this contract?

**A** Yes. The contract to review the structure of the New Zealand company comes within sub-paragraph (ab) of the definition “contract activity”. The consultancy firm therefore comes within the definition of a “non-resident contractor”.

The services undertaken by the non-resident contractor are not all performed in New Zealand. New Zealand only has the right to tax that part of the income that is attributable to the services performed in New Zealand. That

portion of the fees that relates to the services performed outside New Zealand will not have a source in New Zealand.

**NB:**The salaries paid to the employees of the firm have a source in New Zealand in terms of section 243(2)(c) of the Income Tax Act and would, but for section 61(19) of the Act or the Dependent Services article of any relevant Double Taxation Agreement, be liable for income tax in New Zealand.

- 4) A New Zealand company engages the services of a legal firm based in London to research a possible breach of patent. All services undertaken by the legal firm are performed outside New Zealand.

**Q** Do the regulations apply to this contract?

**A** No. The services performed in pursuance of the contract are all performed outside New Zealand. The contract payments made do not have a source in New Zealand.

- 5) A New Zealand company pays fees to a non-resident firm of consultants to undertake a marketing study in Australia with a view to selling a product manufactured in New Zealand on the Australian market.

**Q** Do the regulations apply to this contract?

**A** No. The fees are not subject to the withholding tax as they do not have a source in New Zealand, ie the services are not performed in New Zealand.

- 6) A large multinational company sends two senior management staff to its subsidiary in New Zealand to assist with the management of the New Zealand operations for a period of three months. The parent company charges the salaries of the staff to the New Zealand subsidiary. The staff continue to receive their remuneration from the parent company.

**Q** Do the regulations apply to this contract?

**A** Yes. The parent company (being a non-resident company) has undertaken, by agreement or arrangement, to provide the services of two of its staff to its New Zealand subsidiary. The services pro-

vided to the New Zealand subsidiary come within sub-paragraph (b) of the definition contract activity, ie supplying the use of the services of any person. The foreign company therefore comes within the definition of a non-resident contractor.

**NB:**The salaries paid to the employees of the parent company have a source in New Zealand in terms of section 243(2)(c) of the Income Tax Act and would, but for section 61(19) of the Act or the Dependent Services article of any relevant Double Taxation Agreement, be liable for income tax in New Zealand.

- 7) A non-resident company specialising in the manufacture of aluminium and plastic extrusion machinery sells a machine to a New Zealand company which is in the business of manufacturing aluminium products. The machine is all-computer controlled and one of the first of its kind in New Zealand. Accordingly, it was necessary for the New Zealand purchaser to train staff on the operation of the machine.

It was provided in the purchase agreement that the non-resident company was to provide staff to undertake the necessary training. The New Zealand company was to pay an additional fee for the training together with all expenses incurred by the non-resident company in sending staff to New Zealand.

**Q** Do the regulations apply to this contract?

**A** Yes. The training activities undertaken in New Zealand come within sub-paragraph (b) of the definition of "contract activity". The non-resident company therefore comes within the definition of a "Non-Resident Contractor". The fees payable by the New Zealand company in respect of the services provided by the non-resident company's staff will be subject to withholding tax.

**NB:**Again, with this contract, the salaries derived by the staff of the Non-Resident Contractor have a source in New Zealand in terms of section 243(2)(c) of the Act. However, it is unlikely that the salaries will be liable for income tax in New Zealand because of section 61(19) of the Act or the Dependent Services article of any relevant Double Taxation Agreement.

7a) The New Zealand company is very impressed by the machine, so much so in fact that it enters into an agreement with the non-resident company to manufacture and market the machine in New Zealand.

The non-resident manufacturer grants the New Zealand company exclusive rights to manufacture, market and distribute the machine in the South Pacific. In pursuance of the agreement, the non-resident company grants the New Zealand company the use of the trademark, technical information, specifications, plans and access to the non-resident company's technical staff.

The New Zealand company pays a royalty to the non-resident company in respect of the trademark and knowhow. However, the New Zealand company must pay the non-resident company on an hourly basis for the use of the non-resident company's staff.

**Q** Do the regulations apply to this contract?

**A** No. The royalties paid in respect of Trademark and Knowhow will be subject to Non-Resident Withholding Tax. The fees paid by the New Zealand company in respect of the assistance provided by the non-resident company's staff therefore constitute royalties in terms of paragraph (f) of the definition "Royalty" contained in section 2 of the Income Tax Act. The fees would be subject to Non-Resident Withholding Tax.

## **6.0 WHAT HAPPENS WHEN THE OTHER PROVISIONS OF THE WITHHOLDING PAYMENTS REGULATIONS ALSO APPLY?**

6.1 The amendment to the definition of "Contract Activity" was made so as to ensure payments made under those types of contracts, that were otherwise outside the provisions of the regulations, are now subject to withholding tax.

6.2 As can be seen from example 2 in paragraph 5, the payments made to Non-Resident Contractors may also be subject to withholding tax under other clauses contained in Parts A, B & D of the schedule to the regulations.

6.3 The clauses contained in Parts A, B & D of the schedule to the regulations identify classes of payments that are to be subject to withholding tax. The clauses do not attach themselves to any particular classes of taxpayers, ie they do not distinguish between resident and non resident persons.

6.4 Therefore, where a specific class of payment is made to a person, the rate of withholding tax applicable to that class of payment will apply.