Key Issues in the Design of Capital Gains Tax Regimes: Taxing Non-Residents

18 July 2014
How do we tax non-residents on capital income?

- Domestic design issues
- Tax treaty issues
- Interrelationship between these two
- Technical issues such as whether Article 7 (business profits) or Article 13 (capital gains) applies
Domestic Issues: What are the options?

Do we:
- Comprehensively tax all asset classes; or
- Only selected assets; or
- No assets at all when these assets are owned by non-residents?

The asset classes:
1. real property (owned by a permanent establishment or not);
2. shares in property rich companies;
3. any other assets held by a permanent establishment;
4. movable property not included in either of the two preceding categories (2 or 3)
Why we should tax all property*

- **Revenue**
  New Zealand has a significant amount of its assets owned by non-residents. 102 of the largest 200 New Zealand companies are majority overseas owned.
  Is the choice between source country taxation and no taxation at all? Low rate/Broad base?

- **Equality between residents and non-residents**
  Should New Zealanders be treated less favourably than non-residents and why?

*held by non-residents
The case for a targeted range of assets (part one)

• Attracting foreign direct investment
  Does tax influence FDI?
• The international norm
  Frequently have a definition of "taxable" property consisting of real property, shares in property rich companies, and property owned by a foreign PE
The case for a targeted range of assets (part two)

- Practicalities
  Assessing an overseas vendor on a share sale (identification/assessment/collection)

- Current DTA arrangements
  Should New Zealand embark on a complete renegotiation of its DTAs? Likely to be an undesirable course of action...
New Zealand treaty network (immovable/real property)

- All New Zealand's DTAs broadly follow the OECD Model (Article 13 (1))
- This preserves New Zealand's right to tax all gains from the sale of real property*

*Note there is an issue regarding the scope of Article 13
New Zealand treaty network (movable/personal property belonging to a PE)

- Gains made from the alienation of movable property which forms part of the business of a PE may be taxed in the source state (Article 13 (2))
- All New Zealand DTAs preserve this right to tax
New Zealand treaty network (Gains from the alienation of shares in property rich companies)

- Gains derived from the alienation of shares deriving more than 50% of their value from immovable property may be taxed in the source state (Article 13 (4)) 75% of NZ DTAs conform.
- Some New Zealand DTAs do not contain paragraph (4) meaning that the sale of shares in such property rich companies are dealt with under the default paragraph (this is discussed at Article 13 (5)).
- New Zealand has nine DTAs where there is no equivalent to Article 13 (4).

Belgium
Denmark
Germany
Indonesia
Korea
Netherlands
Philippines
Switzerland
United Arab Emirates
New Zealand treaty network (the default paragraph (Art 13(5)))

• Article 13 (5) of the OECD Model provides for exclusive taxation in the residence state

• We sometimes follow this OECD Model and sometimes preserve source taxing rights (i.e. we retain the right to tax New Zealand sourced capital profits)
New Zealand treaty network (the default paragraph (Art 13(5)))

<table>
<thead>
<tr>
<th>(5) Other gains taxable at source</th>
<th>Other gains taxable in State of residence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>Australia</td>
</tr>
<tr>
<td>Chile</td>
<td>Austria</td>
</tr>
<tr>
<td>China</td>
<td>Belgium</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Denmark</td>
</tr>
<tr>
<td>Fiji</td>
<td>Finland</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>France</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Germany</td>
</tr>
<tr>
<td>Mexico</td>
<td>India</td>
</tr>
<tr>
<td>Norway</td>
<td>Indonesia</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>Ireland</td>
</tr>
<tr>
<td>Poland</td>
<td>Italy</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>Japan</td>
</tr>
<tr>
<td>Singapore</td>
<td>Korea</td>
</tr>
<tr>
<td>South Africa</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Sweden</td>
<td>Philippines</td>
</tr>
<tr>
<td>Taiwan</td>
<td>Spain</td>
</tr>
<tr>
<td>Thailand</td>
<td>Switzerland</td>
</tr>
<tr>
<td>Turkey</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>Vietnam</td>
<td>United Kingdom</td>
</tr>
<tr>
<td></td>
<td>United States of America</td>
</tr>
</tbody>
</table>
New Zealand treaty network (the default paragraph (Art 13(5)))

- Taxation of New Zealand movable property (which is not part of the business property of a PE) has been allocated to the residence (investor) state in respect of 20 DTAs.
Conclusions on DTA network

- Taxation of real property is not constrained
- Taxation of New Zealand movable property (shares and other business assets) which are part of the business property of a PE is not constrained
- Taxation of New Zealand companies which principally own New Zealand real property is constrained in respect of 25% of DTAs
- Taxation of New Zealand movable property not dealt with in any of the above situations is constrained in respect of 20 New Zealand DTAs (approximately half)
Observations about taxing non-residents

- Comprehensive taxation is fairer to New Zealand residents and may increase revenue.
- Targeting real property, shares in property rich companies and business assets held by PEs can be rationalised because of the existing DTA network which will prevent taxation in many situations.
- Limiting the comprehensiveness of taxation may encourage FDI, conform with international practice, recognise the practicality of assessment and collection, and discourage inappropriate treaty shopping.