Income Taxation Impedes Closer Economic Relations Between Australia and New Zealand

by

Joan Wells

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By

Joan Wells
Senior Lecturer
Swinburne University of Technology
Hawthorn, Victoria, Australia
Phone: 03 **8198461**
Fax: 03 8190949

ABSTRACT:

This paper identifies specific taxation provisions that impede trans-Tasman investment. It does this within the context of the Australia and New **Zealand** Closer Economic Trade Relations (CER). It illustrates that equity investors are better off investing in their **own** countries, or indeed in other countries rather than trans-Tasman. Finally it identifies alternative reforms **which** could overcome these impediments.

The author appreciates the comments and assistance given by Professor **Alf** Clark and Associate Professor Helen **Paterson** from **Swinburne** University, Ms Barbara Burns from Royal **Melbourne** Institute of Technology and Mr Ray Hair from Deloitte Touche Tohmatsu.

INCOME TAXATION IMPEDES CLOSER ECONOMIC RELATIONS BETWEEN AUSTRALIA AND NEW ZEALAND:

INTRODUCTION

There are currently a number of impediments to trans-Tasman trade and investment which require consideration by both the New Zealand and Australian Governments. One of these impediments is the current disharmony between the New Zealand and Australian taxation systems. This paper identifies specific taxation provisions that impede trans-Tasman investment. It does this within the context of the Australia and New Zealand Closer Economic Trade Relations (CER). It illustrates that equity investors are better off investing in their own countries, or indeed in another country rather than trans-Tasman. Finally it identifies alternative reforms which could overcome these impediments.

Three major taxation impediments to trans-Tasman investment are:

- The inability of both New Zealand and Australian individual shareholders to utilise dividend imputation credits arising from taxes paid on the other side of the Tasman,
- the liability in New Zealand to Non-Resident Withholding Tax (NRWT) of 15% where dividends are paid (even out of fully-taxed profits) to an Australian resident,
  and
- the liability in New Zealand to a Foreign Dividend Withholding Payment (FDWP) of 33% where a New Zealand company receives a dividend from an Australian resident.

Whilst these are not the only disharmonies in the respective taxation systems, they do give rise to significant tax costs to trans-Tasman equity investors. Details of the legislation relevant to dividend and for comparison purposes, interest income is contained in the Appendix to this paper. As a result of these disharmonies, the effective tax rates payable by an individual shareholder investing trans-Tasman (see Table 1 and 2) can vary between;

. 70.53% for an Australian shareholder investing in a New Zealand company and
. 59.13% for a New Zealand shareholder investing in an Australian company.

This compares with effective tax rates payable by an individual investing domestically of;

. 48.25% for an Australian shareholder investing in an Australian company and

. 33% for a New Zealand shareholder investing in a New Zealand company.

The objectives of the Closer Economic Relations Agreement between New Zealand and Australia are being impeded by taxation provisions which discourage and distort trans-Tasman investment by imposing punitive tax rates on equity investment. The 1992 review, while recognizing these disharmonies failed to resolve them.

THE AUSTRALIAN NEW ZEALAND CLOSER ECONOMIC TRADE RELATIONS AGREEMENT

The Australia New Zealand Closer Economic Trade Relations Agreement(CER) came into effect on 1 January 1983 (Department of Foreign Affairs and Trade, 1991).

The stated objectives of the CER Agreement are:

- to strengthen the broader relationship between Australia and New Zealand;
- to develop closer economic relations between the Member States through a mutually beneficial expansion of free trade between Australia and New Zealand;
- to eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner under an agreed timetable and with a minimum of disruption; and
- to develop trade between New Zealand and Australia under conditions of fair competition.

At the time of the signing of the original agreement (1983) the taxation systems of the two countries were similar. There was no dividend imputation, no capital gains tax, no fringe benefits tax, and no consumption or goods and services taxes (it is interesting to note in 1983 that both countries were planning on the introduction of a goods and services tax). The company tax rate was 45% in New Zealand and 46% in Australia. There did not appear to be any need to harmonise the tax systems of the two countries. Trans-Tasman equity investment was not significantly impacted by dissimilarities in the respective tax systems.

Now the position is quite different:

- Australia has a capital gains tax or at least an income tax on capital gains.
- New Zealand has a goods and services tax.
- Both countries have imputation of dividends but do not recognise trans-Tasman transfer of imputation credits.
- Both companies have a fringe benefits tax and there is no relief from the double taxation of fringe benefits.
- New Zealand imposes a foreign dividend withholding payment (FDWP) on dividends to a New Zealand company from a non resident source.
- New Zealand imposes a non resident withholding tax on dividends paid to non residents even when those dividends are fully franked.
- The company tax rate is now 33% in New Zealand and 39% in Australia.

As a result of the tax reform process, there are now substantial differences in the taxation systems which work against closer economic relations between the two countries by disadvantaging trans-Tasman equity investment.

Prior to the 1988 Review of CER the point was made that both countries were introducing an imputation system and as a consequence the Double Taxation Agreement between the two countries would need to be revised. "Given the objectives of the two Governments and the growth of trans-Tasman investment under CER, careful attention should be paid by both Governments to avoiding undesirable anomalies and to ensuring as far as possible that income is not taxed more than once, or when it is, that tax paid is allowed as a credit to shareholders through the imputation systems on both sides of the Tasman" (Holmes 1986, p. 96). Unfortunately the 1988 review did not address any of the problems of the lack of tax harmonisation. However free trade in commodities between Australia and New Zealand was achieved on 1 July 1990 with all tariffs, import licensing, quantitative restrictions and export incentives restricting trade between the two counties being removed. This was five years ahead of the date specified in the original Agreement. The progress towards CER is being made by a rapid expansion of trade between New Zealand and Australia. Australian imports from New Zealand were $694.3 million in 1983 and have grown 213% to

$2175.0 million in 1990. New Zealand imports from Australia were $1,367.9 million in 1983 and have grown 119% to $2,999 million in 1990 (Lloyd 1991, p. 14).

The 1992 review was completed in October. According to a joint statement released by both the Australian and New Zealand Prime Ministers on 14 October 1991;

. trans-Tasman shipping,

. specific taxation arrangements which may be impeding bilateral trade and investment

. trade in services

. further harmonisation of business laws, standards, customs and quarantine arrangements and

. an examination of the mutual recognition of professional and other qualifications

were on the review agenda. Unfortunately no progress has been made to date on the taxation impediments trans-Tasman.

THE IMPACT OF THE LACK OF TAX HARMONISATION ON TRANS-TASMAN INVESTMENT

The impact of the lack of tax harmonisation on the eventual tax paid by both the Australian investor and the New Zealand investor on fully franked dividends is presented in Tables 1 and 2. (For the purposes of this paper all companies are assumed to be public companies.)

TABLE 1

A COMPARISON OF THE EFFECTIVE TAX RATES PAID BY A SHAREHOLDER DOMESTICALLY AND CROSS TASMAN THROUGH A RESIDENT HOLDING COMPANY:

	AUST SUBSIDIARY CO NZ HOLDING CO NZ SHAREHOLDER	NZ SUBSIDIARY CO AUST HOLDING CO AUST SHAREHOLDER	NZ SUBSIDIARY CO NZ HOLDING CO NZ SHAREHOLDER	AUST SUBSIDIARY CO AUST HOLDING CO AUST SHAREHOLDER
SUBSIDIARY CO.				
Profit	100	100	100	100
Tax	39	33	33	39
Profit after tax	61	67	67	61
Div paid	61	67	67	61
NRWT 15%	-	10.05	-	
HOLDING CO:				
Div	61	56.95	67	61
FDWP 33%	20.13	-	-	-
Div rec	40.87	56.95	67	61
Tax	-	-	-	-
INDIVIDUAL SHAREHOLDER:				
Div	61	56.95	67	61
Tax	20.13	27.48	33	48.25
Imput credit	-	-	(33)	(39)
Rebate FDWP	(20.1 3)	-	-	-
Div after tax	40.87	29.47	67	51.75
EFFECTIVE TAX **RATE:**	**59.13%**	**70.53%**	**33%**	**48.25%**

In Table 1 the first two columns compare investment trans-Tasman, while the third and fourth columns gives the domestic position for comparison purposes.

- On company profits the company is taxed 39% in Australia and 33% in New Zealand. If dividends are remitted trans-Tasman fully franked, in Australia there is no additional tax, however, in New Zealand there is a Non Resident Withholding Tax (NRWT) of 15% on the net dividend paid to the non resident recipient.

- When the dividend is received by the holding company there is no **tax** liability, the dividend is effectively exempt from tax and as a result any rebate of withholding tax is lost. On receipt of the foreign dividend by the New Zealand company the New Zealand taxing authorities impose a Foreign Dividend Withholding Payment (FDWP) of 33% which attaches to the dividend until it is eventually distributed.
- When the dividend is paid by the holding company to the shareholder the New Zealander is taxed at 33% but receives a credit for the FDWP. The Australian shareholder pays 48.25% on the dividend received. (Refer to the attached Appendix)

The final effective tax rate paid by a shareholder making trans-Tasman investments is 59.13% for the New Zealand shareholder and 70.53% for the Australian shareholder. Compared to domestic tax payable of 33% for the New Zealand shareholder and 48.25% for the Australian shareholder, the trans-Tasman rate paid is 179% of what would be paid domestically by the New Zealand investor and 146% of what would be paid domestically by an Australian investor.

Implications:

Because of the lack of harmonisation between the two taxation systems;

- There is an incentive for shareholders to invest domestically rather than trans-Tasman caused by the lack of recognition of imputation credits trans-Tasman.
- There is a disincentive to repatriate profits out of New Zealand caused by the NRWT on dividends even when these dividends have imputation credits attached.
- There is a disincentive to repatriate profits into New Zealand caused by the FDWP which is not

recoverable unless the dividends brought in, are fully distributed.

TABLE 2

A COMPARISON OF THE EFFECTIVE TAX RATES PAID BY A SHAREHOLDER INVESTING CROSS TASMAN THROUGH A HOLDING COMPANY WITH A CROSS TASMAN SUBSIDIARY:

	NZ SUBSIDIARY CO AUST HOLDING CO NZ SHAREHOLDER	AUST SUBSIDIARY CO NZ HOLDING CO AUST SHAREHOLDER
SUBSIDIARY CO:		
Profit	100	100
Tax	33	39
Profit after tax	67	61
Dividend paid(trans-Tasman)	56.95	61
NRWT 15%	10.05	
HOLDING CO:		
Dividend received	56.95	61
FDWP 33%	-	20.13
Tax	-	-
NRWT	-	9.15
FDWP offset		(9.15)
INDIVIDUAL SHAREHOLDER:		
Dividend received	56.95	40.87
Refund FDWP	-	(10.98)
Taxable dividend	56.95	61.00
Tax	18.80	29.43
Rebate	-	(9.15)
Dividend after tax	38.16	31.57
EFFECTIVE TAX RATE:	**61.84%**	**68.43%**

Table 2 gives the final effective tax rates payable if dividends cross the Tasman twice.

The New Zealand company pays 33% tax on profits and the Australian company pays 39%.

- There is no recognition of imputation credits trans-Tasman. When the New Zealand company remits the dividend trans-Tasman it has to pay the Non Resident Withholding Tax of 15%. There is no withholding tax on dividends which are fully franked in Australia. On receipt of the dividend the New Zealand company has to pay a Foreign Dividend Withholding Payment of 33% from the dividend received. Neither holding company pays tax on the dividend received so the Non Resident Withholding Tax credit is lost. The New Zealand company has to deduct a Non Resident Withholding Tax of 15% but there is an offset of the Foreign Dividend Withholding Payment.
- With respect to the individual shareholder, the New Zealand shareholder receives $56.95, pays

tax on $56.95 at a rate of 33% which leaves $38.16 after tax. The Australian shareholder receives $40.87, gets a refund of the remainder of the Foreign Dividend Withholding Payment of $10.98 and pays tax at a domestic rate of 48.25% on $61.00 which leaves him/her with a final dividend of $31.57 after tax (refer to the attached Appendix). In this situation the New Zealander pays 61.84% and the Australian pays 68.43% which is 187% and 142% of the domestic rate, respectively.

Implications:

In addition to the points made in Table 1, it is interesting to note that while the New Zealander is worse off if the dividends cross the Tasman more than once, the Australian investor is in fact better off. This is because the dividend paid by the New Zealand company trans-Tasman is to an individual, rather than a company as in the previous Table. The non-resident withholding tax credit can be claimed by the Australian shareholder to reduce his/her tax payable.

TABLE 3:

TAX ON RETURNS FROM AN AUSTRALIAN INVESTMENT IN OTHER COUNTRIES AS COMPARED TO AN EQUIVALENT INVESTMENT IN AUSTRALIA:

Expressed as a Percentage of Australian Tax Payable:

	%
New Zealand	151
United States of America	135
United Kingdom	127
Japan	116
Singapore	109

(Bureau of Industry Economics 1988, Table A-28)

Table 3 compares the relative effective tax rates paid on an overseas equity investment relative to domestic investment in Australia by an Australian shareholder. The difference between 151% in Table 3 and 146% derived in Table 1 is that the statistics developed by the Bureau of Industry Economics incorporate the different inflation rates in each country and the different depreciation deductions allowed under each country's taxation regulations.

Implications:

The impact of trans-Tasman tax disharmony is particularly evident if investment trans-Tasman is compared with investment into USA, UK, Japan or Singapore. Australian shareholders pay less tax relatively if they invest in the USA, UK, Japan or Singapore rather than in New Zealand (Downey 1990, p. 226). Investment into New Zealand, a country with which for nearly a decade we have had a formal agreement of closer economic relations is less tax efficient than investment in any of the other countries cited above.

TABLE 4

A COMPARISON OF THE EFFECTIVE TAX RATES PAID BY AN INVESTOR INVESTING TRANS-TASMAN AND DOMESTICALLY USING A BOND ARRANGEMENT:

	NZ INDIVIDUAL AUST COMPANY	AUST INDIVIDUAL NZ COMPANY	NZ INDIVIDUAL NZ COMPANY	AUST INDIVIDUAL AUST COMPANY
COMPANY:				
Co profit	100	100	100	100
Interest	100	100	100	100
Tax	nil	nil	nil	nil
NRWT	10	10	nil	nil
INVESTOR:				
Net interest rec	90	90	100	100
Tax payable	33	48.25	33	48.25
Rebate NRWT	(10)	(10)	-	-
After tax interest rec	67	51.75	67	51.75
EFFECTIVE TAX RATE:	**33%**	**48.25%**	**33%**	**48.25%**

Table 4 compares an investment by an individual in a non associated company trans-Tasman with a similar investment domestically. Starting with the same $100 profit, interest is fully tax deductible, the tax is nil in both Australia and New Zealand. The company has to withhold a Foreign Interest Withholding Tax of 10%. The investor receives the net interest of $90, pays tax on the grossed up amount of $100, gets a rebate of the tax withheld and eventually pays the same tax as if he/she had invested domestically. The lack of tax harmonisation trans-Tasman has no impact on an individual investor who uses a bond facility. The final tax payable is the same whether the taxpayer invests domestically or trans-Tasman.

Implications:

The real disadvantage of the lack of tax harmonisation is felt by the provider of equity financing. Instead of taxes of 33% and 48.25% payable domestically, respectively, the rates can be as high as 61.84% for a New Zealand investor and 70.53% for an Australian investor when investing in equity. This is primarily the consequence of the lack of government response to a situation that has existed since the introduction of dividend imputation. The system as it stands now favours investment in debt financing as opposed to equity financing. This is undesirable on a macro economic level when you consider that foreign indebtedness is a major concern of both the Australian and New Zealand Governments. It is also undesirable on a micro-economic level when the shortage of owner equity ie. risk capital is a concern of most industrialised countries.

REFORMS NE RY TO ACHIEVE HARMONISATION

There are at least three major methods of improving harmonisation:

- Use the tax treaties between the two countries to try to achieve harmonisation.
- Legislate domestically within each country and
- Negotiate an agreement outside of the tax treaties.

INTERNATIONAL TAX AGREEMENTS

The Double Tax Treaties which Australia has entered into are largely based on the OECD Model Convention for the Avoidance of Double Taxation. The OECD Model Convention and Commentary on Tax Treaties states, "The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons; they should not, however, help tax avoidance or evasion" (CCH 1992, p.533). So it can be seen even without CER there is an argument for rectifying the situation which exists between New Zealand and Australia based on this OECD Convention.

The OECD Convention recognised the problem of the taxation of dividends received by individuals and has a policy, which if followed, would lead to a revision of the New Zealand Australian Treaty. The Convention identifies three methods of taxing dividends in the hands of individual shareholders which would impact on Tax Treaties between States (countries).

- The first is identified as the classical system, where dividends in the hands of the individual shareholder have been taxed twice. In this case there is no justification for incorporating into a Tax Treaty between two countries an allowance for a credit for company tax paid. This is the system that existed at the time CER was signed. Both Australia and New Zealand had a classical system and therefore there was no need to recognise company tax imputation.
- The second dividend system is the split rate system where countries tax undistributed profits differently to distributed profits. This system is not relevant to our consideration of the New Zealand and Australia tax systems.
- The third system of dividends identified is where a state taxes the whole of company profits whether distributed or not and the dividends are taxed in the hands of the resident shareholder (an individual). The shareholder however is entitled to a tax credit against his/her personal tax on the grounds that, in the normal course at least, the dividend has borne company tax as part of the company's profits. This is the current system in Australia and New Zealand. The credit is normally allowed only to residents and only in respect of dividends from domestic sources. However, in recent Conventions, some States have extended the right to the tax credit to residents of other Contracting States. The United Kingdom and the United States, Ireland and the United Kingdom and France and the United Kingdom all recognise each others tax credits.

The OECD conceded that where a country extended the recognition of tax credits, for example United Kingdom and France, there was a bias against countries not party to the agreement however, it was not considered realistic to require a country with domestic imputation of dividends to extend tax credits to all non residents. If, for example, such an arrangement was offered to a country which had the classical system of taxing dividend income then in fact there would be a bias towards investment in that treaty country as opposed to investment domestically.

In considering the difficulty of dividend imputation the OECD Convention came to the conclusion "When everything is fully considered, it seems that the problem can be solved only in bilateral negotiations. n·here one is better placed to evaluate the sacrifices and advantages which the Convention must bring for each Contracting State"(CCH 1992, p.628). The answers as to why the Tax Treaty k e e n New Zealand and Australia has not been renegotiated **are not to** be **found** directly in the OECD Convention. In fact the opposite, the Convention indicates the need to negotiate bilaterally as has been done by the United Kingdom and the United States, by Ireland and the United Kingdom and by France and the United Kingdom.

Some of the answers are to be found as follows:

- If Australia and New Zealand revise their treaty to recognise imputation credits, then both countries would have to recognise that they could not refuse to extend the same treaty arrangements to those other countries that recognise imputation credits in the taxation of dividends of individuals, eg UK, USA, Ireland, Germany and Canada. Anti discrimination clauses contained in double tax treaties which Australia and New Zealand maintain with other countries, in particular, the United States prohibit the granting of special status to Australia and New Zealand without granting a similar concession to other countries (Shewan 1990, p. 248). As a consequence, a substantial loss of tax revenue would be incurred by both the New Zealand and Australian Governments as major capital importing countries particularly importing capital from the UK and USA. Australia would not suffer as large a loss because the Non Resident Withholding Tax has been removed on dividends that carry a dividend imputation credit.

- The Double Tax Agreement between Australia and New Zealand has not been renegotiated since 1972 and given the extensive changes in the tax systems of both countries since that time, there is a need to update this agreement even aside from the difficulties of dividend imputation. The UK has been able to arrange the transfer of imputation credits with France, the United States of America and Ireland and this has been done through the tax treaties. The Australia United Kingdom Agreement was updated in 1980 to accommodate the changes in the taxation of dividends. but this update predated dividend imputation. The revised United States Convention with Australia came into force in 1982, although royalties not dividends was the major issue of this update. The Singapore Agreement with Australia was updated in 1989. However the Japanese Agreement has not been revised since 1969. The point has to be made that the Tax Treaty between Australia and New Zealand is in need of updating to remove impediments to trans-Tasman investment and closer economic relations.

- Another impediment to the use of a trans-Tasman treaty or arrangement is the impact on the bilateral treaties that both countries have with other countries. For example Australia is obligated under its Nara Treaty with Japan to give Japan the same investment treatment that any other country receives from Australia (Downey 1990 p. 219). If Australia and New Zealand were to endeavour to use **CER** to effect preferential investment between Australia and New Zealand then Australia would be pressured to extend the same treatment to the Japanese as a consequence of the Nara Treaty.

DOMESTIC LEGISLATION

The bilateral recognition of imputation credits could be achieved through domestic legislation. New Zealand's legislation is already in place (refer to the attached Appendix). New Zealand recognises income tax paid overseas and allows a credit for that tax. It specifically disallows the recognition of Australian imputation credits because Australia does not recognise New Zealand imputation credits. Company tax attached to dividends sourced in the United Kingdom is recognised in New Zealand. Australia has failed to match New Zealand in readiness to recognise imputation credits and it is up to Australia to do so.

Another area worth exploring as a means of overcoming the lack of tax harmonisation is to allow dividend streaming by those companies who operate holding companies and subsidiaries in New Zealand and Australia. This would overcome to some extent the inequities being experienced at the moment. The UK for example allows dividend steaming. Presently if an Australian company pays a franked dividend to an Australian resident it has to pay a franked dividend to the New Zealand resident (refer to the attached Appendix) and as was pointed out in Table 1 and 2 the imputation credit trans-Tasman is lost. If the dividend streaming rules or regulations were modified, referring to Table 2, profits from the New Zealand subsidiary could be used to pay dividends to New Zealand residents without loss of imputation credit, and without the additional impost of NRWT and FDWP. New Zealand has similar laws with respect to disallowing dividend streaming (refer appendix). Obviously the issue is much larger than **CER,** if dividend streaming were allowed, then, for example given the extent of UK investment, the impact on the treasuries of both countries would be considerable. The present developments both in Australia and New Zealand are towards the tightening of the restriction on dividend streaming. So it is thought unlikely the either country would contemplate the easing of restrictions on streaming.

There is much which can be achieved when considering the other facets of the impediments to tax harmonisation. The New Zealand tax system is seen by business to be hostile to inwards and outwards investment. This point is made most forcible when looking at statistics such as those in Table 3. The NRWT and the FDWP when imposed on imputed dividends result in prohibitive tax rates to investors. The removal of these taxes unfortunately would result in such a loss of revenue to the New Zealand Government that it is unlikely that they will be removed.

ARRANGEMENTS OUTSIDE THE DOUBLE TAX TREATIES AND TAX LEGISLATION

Shewan suggests that to overcome the problems identified while looking at the above alternatives of renegotiating the treaties or changing domestic legislation perhaps a "treasury reimbursement" should be utilised whereby "...... Australia would grant imputation credits to its residents who held shares in Australian or New Zealand resident companies, and New Zealand would grant credits to its residents who own shares in New Zealand and Australian companies. Each year an appropriate adjustment would be made between the treasuries of each country so that the cost of granting credits in respect of dividends on which local corporate tax had not been collected would be passed on to an agreed extent to the other treasury" (Shewan 1990, p. 249)

In the light of the pressures from outside Australia, eg. from the Japanese when looking at investment agreements, and from all other countries which frank their dividends when considering recognising imputation credits, the achievement of tax harmonisation might have to be arrived at administratively as opposed to through treaties or legislation.

CONCLUSION

The major differences in the income tax systems of Australia and New Zealand is the presence of a goods and services tax and the absence of a capital gains tax in New Zealand. The fact that the two systems are different is acceptable. The tenant of **CER** was not to achieve the same taxation systems. trade laws. currencies and legal systems but to result in the removal of impediments to trade and the mutual development of the two economic systems. The aim of CER is to encourage trans-Tasman trade, trade creation and investment. At present in spite of the fact that CER has been in existence for nearly a decade it is more attractive tax wise to invest in equity domestically in Australia or New Zealand or from Australia's perspective to invest with another country eg Japan, United Kingdom, United States or Singapore than it is to invest in New Zealand. Australian and New Zealand shareholders get a better return investing in the UK than they do investing in each other. Tax disharmony is currently operating as a major obstacle to trans-Tasman investment.

There are three major tax impediments to investment across the Tasman.

- The failure of the Australian Government to recognise imputation credits from across the Tasman. In this paper the full impact of this disharmony has been spelt out.

- The continuation of New Zealand to impose a withholding tax on dividends paid to non residents even when those dividends carry New Zealand imputation credits.

- The continuation of New Zealand to impose a Foreign Dividend Withholding Payment on dividends received from non residents.

The problem with regard to the lack of tax harmonisation was identified as long ago as 1986 and although there has been a lot of rhetoric from the politicians and public servants nothing to improve of tax harmonisation has been accomplished. Some of the reasons why tax harmonisation is taking so long and why it is in the "too hard basket" have been canvassed in this paper. Basically pressures from other countries to extend the same privileges and the potential loss to the respective governments of tax revenues are the major reasons. Nevertheless given these difficulties, if Australia and New Zealand are serious about CER and given the progress that has been made in trade and to some degree in shipping the countries should continue to pursue closer economic relations.

To avoid continuing impediments to trans-Tasman investment, distortions to the way that investment is structured and to the way trans-Tasman business is executed, it is recommended:

- That Australia recognise New Zealand imputation credits so that Australian individual shareholders in New Zealand companies can claim a credit for New Zealand tax paid and then New Zealand individual shareholders in Australian companies can claim a credit for Australian tax paid, through the operation of existing New Zealand taxation legislation (refer attached Appendix) and

- That New Zealand legislate domestically to match Australia in abolishing the Non-Resident Withholding Tax on dividends paid from corporate profits which have been subject to underlying New Zealand tax and to match Australia in not imposing a 33% Foreign Dividend Withholding Payment on dividends received from Australian companies.

A Review of the CER Agreement was completed in 1992. The issues raised in this paper were addressed. Unfortunately they were not resolved and the impediments to Closer Economic Relations between Australia and New Zealand caused by tax disharmonies still remain.

APPENDIX

AUSTRALIAN INCOME TAX ASSESSMENT ACT 1936

Non resident withholding tax - dividends:

Does not apply to dividends paid on or after 1 July 1987 to the extent that they have been "franked" by the paying company under the imputation system. To the extent that such dividends are not franked they are subject to non resident withholding tax, section 128B.

Imputation credits:

Non-resident shareholders are generally not entitled to imputation credits or rebates, section 160APK.

Inter corporate dividends:

Normally a non-portfolio dividend paid by a company resident in a listed country to a resident company will be exempt under section 23AJ. Being exempt, no foreign tax credit is available.

Dividend streaming:

Provisions to discourage dividend streaming are contained in section 160AQCB, the effect of this section is that franking debits are incurred when distributions are made under dividend streaming arrangements.

Interest income:

Interest derived by a non-resident is generally subject to a withholding tax under sections 128A, B and C. The Double Tax Agreement with New Zealand limits this to 10%.

NEW ZEALAND INCOME TAX ACT 1976

Non resident withholding tax - dividends:

Non resident withholding tax (NRWT) is imposed on dividends derived in New Zealand by persons not resident in New Zealand, sections 312 and 311.

Imputation credits:

Income tax paid overseas on overseas income is allowed as a credit against income tax payable in New Zealand. The tax paid must be substantially of the same nature as the tax paid in New Zealand or be a non resident withholding tax. However New Zealand residents who receive dividends carrying imputation credits from Australia are taxed on the actual amount received with no allowance for imputation credits. If the dividends are unfranked then dividends are taxed as previously. grossed up to the extent of the withholding tax and credit given for foreign withholding tax paid. sections 293 and 394ZC.

Intercorporate dividends:

Companies resident in New Zealand are exempt from income tax in respect of dividend income from a foreign company. section 63(2A).

Dividend streaming:

Provisions to discourage dividend streaming arrangements are contained in section 394ZG, the effect of this section is to cause companies to incur franking debits when distributions are made under dividend streaming arrangements.

Foreign dividend withholding payments:

Section 394ZL requires companies resident in New Zealand to make a deduction by way of a dividend withholding payment from foreign source dividends. Section 394ZQ states that the commissioner shall pay to the shareholder by way of a refund of dividend withholding credit an amount equal to the amount of the dividend withholding payment less any non-resident witholding tax payable.

Interest income:

Interest derived by non-residents is subject to a witholding tax (NRWT) under sections 310 and 311. The Double Tax Agreement with Australia limits this tax to 10%.

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