

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA
TŪMATAITI

Permanent establishment

Decision date | Rā o te Whakatau: 24 July 2024

Issue date | Rā Tuku: 12 November 2024

TDS 24/20

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Subjects | Kaupapa

The provision of services by a New Zealand company to an overseas company. Whether the overseas company had a permanent establishment in New Zealand.

Taxation laws | Ture tāke

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

Facts | Meka

1. The Arrangement was that an overseas resident company (OS Co) had engaged a New Zealand resident company (NZ Co) to undertake work in New Zealand. Some of OS Co's employees would:
 - take a leave of absence from OS Co;
 - temporarily move to New Zealand; and
 - be employed directly by NZ Co on fixed term contracts.
2. OS Co would pay NZ Co a fee on a costs plus basis for the services NZ Co provided to OS Co. The terms of the contract (including the service fee) would be on an arm's-length basis.
3. OS Co did not have:
 - its head office in New Zealand;
 - its centre of management in New Zealand; or
 - its directors, in their capacity as directors, exercising control of OS Co in New Zealand.
4. Unless they were on a leave of absence from OS Co, none of OS Co's employees would be present in New Zealand performing services for OS Co under the Arrangement.
5. For the purposes of the Act OS Co and NZ Co are not associated.
6. OS Co would not:
 - have any use, access, or authority over, NZ Co's premises;
 - be using or carrying on business through NZ Co's premises; and

- have a place of management or branch in New Zealand at NZ Co's premises.
7. NZ Co would have a fixed place of business in New Zealand (office premises). As noted above, NZ Co's initial employees would be staff who temporarily moved to New Zealand and who entered into fixed term employment contracts with NZ Co. NZ Co and its employees would have no authority to enter into contracts on behalf of OS Co.

Issues | Take

8. The main issues considered in this ruling were whether entering and performing the Arrangement:
- resulted in OS Co being "resident in New Zealand" as defined in s YA 1;
 - created a "permanent establishment" for OS Co as that term is defined in s YD 4B;
 - resulted in s GB 54 applying to OS Co;
 - resulted in OS Co having income that was treated as having a source in New Zealand under s YD 4;
 - gave rise to "assessable income" for OS Co for the purposes of s BD 1(5).
9. In addition, the Tax Counsel Office (TCO) considered whether the Arrangement was a "tax avoidance arrangement" under s BG 1.

Decisions | Whakatauranga

10. TCO decided that entering and performing the Arrangement did not:
- result in OS Co being "resident in New Zealand" as defined in s YA 1;
 - create a "permanent establishment" as defined in s YD 4B for OS Co;
 - result in s GB 54 applying to OS Co;
 - result in OS Co having income that was treated as having a source in New Zealand under s YD 4;
 - give rise to "assessable income" for OS Co under s BD 1(5).
11. TCO also decided that s BG 1 did not apply to the Arrangement.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Residence

12. The issue was whether entering into and performing the Arrangement resulted in OS Co being "resident in New Zealand" as defined in s YA 1.
13. Section YA 1 relevantly states that "New Zealand resident" means a person resident in New Zealand under sections YD 1 to YD 3B.
14. Section YD 2(1) provides that a company is a New Zealand resident for the purposes of the Act if one of the following four elements is satisfied:
 - it is incorporated in New Zealand;
 - its head office is in New Zealand;
 - its centre of management is in New Zealand;
 - 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.
15. TCO considered the description of the Arrangement (see above at [1]-[7]) and concluded that OS Co was not New Zealand resident under s YD 2 because, none of the four elements was satisfied.

Issue 2 | Take tuarua: Permanent establishment

16. The issue was whether entering and performing the Arrangement created a "permanent establishment" for OS Co as that term is defined in s YD 4B.
17. Section YD 4B(2)(a) relevantly states that "permanent establishment", for an enterprise that is resident in a country or territory with which New Zealand has a double tax agreement (DTA) that includes a definition of permanent establishment, has the meaning given by the DTA. TCO noted that there was a DTA between New Zealand and the country where OS Co was resident.
18. TCO considered the OECD Model Commentary when interpreting article 5 of the DTA:¹

¹ *CIR v JFP Energy Inc* [1990] 3 NZLR 536.

- *Article 5(1) – general definition of permanent establishment:* Means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
- *Article 5(2) – examples of permanent establishments such an office or branch:* This paragraph contains an inclusive list of examples of places of business, each of which could be regarded as constituting a permanent establishment under paragraph 1.

The facts show that NZ Co established an office in New Zealand. However, OS Co would not:

- have any use, access, or authority over, NZ Co’s premises;
- be using or carrying on its business through NZ Co’s premises; and
- have a place of management or branch at NZ Co’s premises.

Therefore, OS Co would not have a permanent establishment under art 5(2).

- *Article 5(3) – building sites, construction or installation project:* This provision did not apply to OS Co.
- *Article 5(4) – exclusions from permanent establishment:* The exclusion did not apply to OS Co.
- *Article 5(5) – authority to conclude contracts:* Article 5(5) deems a permanent establishment to exist if a dependent agent has the authority to conclude contracts on behalf of the non-resident.

NZ Co did not have the authority to conclude contracts on behalf of OS Co.

- *Article 5(6) – independent agent:* This provision did not apply to OS Co.
- *Article 5(7) – subsidiary:* This provision did not apply to OS Co.

19. Accordingly, TCO concluded that OS Co would not have a permanent establishment under the DTA. Therefore, OS Co would not have a permanent establishment under s YD 4B(2)(a).

Issue 3 | Take tuatoru: Section GB 54

20. The issue was whether entering and performing the Arrangement resulted in s GB 54 applying to OS Co.
21. The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 (BEPS Act 2018) introduced s GB 54, a permanent establishment specific anti-avoidance rule for large multinational groups supplying goods or services into New Zealand. If s GB 54 applied

(and in very broad terms), a non-resident supplier of goods or services to a person in New Zealand would be deemed to have a permanent establishment in New Zealand.

22. TCO observed that the provisions operated in the following way:
- Section GB 54 deems a permanent establishment to exist under the Act.
 - The non-resident person is deemed to have a permanent establishment for the purposes of any applicable double tax agreement.
 - If there is an applicable double tax agreement, the business profits article of the double tax agreement will allow New Zealand to tax the profits attributable to that permanent establishment.
 - Different rules apply if there is no double tax agreement with New Zealand.
23. TCO summarised that s GB 54 requires all the following requirements to be met before deeming a permanent establishment to exist:
- The non-resident makes a supply of goods or services to a person in New Zealand either directly or through an intermediary.
 - A person (the "facilitator") carries out an activity in New Zealand for the purpose of bringing about that particular supply.
 - The facilitator is associated with the non-resident, is an employee of the non-resident, or is commercially dependent on the non-resident.
 - The facilitator's activities are more than preparatory or auxiliary to the non-resident's supply.
 - The non-resident's income from the supply is subject to a double tax agreement that does not include the OECD's latest permanent establishment article.
 - A more than merely incidental purpose or effect of the arrangement is to avoid New Zealand tax, or a combination of New Zealand tax and foreign tax.
 - The non-resident is part of a large multinational group. The OECD has defined a "large multinational group" as a group with at least €750m of consolidated global turnover for the purpose of filing Country-by-Country reports. The same revenue threshold is used for s GB 54.
24. TCO noted that, on the face of it, OS Co was not intentionally making any supplies to a New Zealand recipient. The services OS Co supplied occurred in the overseas jurisdiction. However, unknown to OS Co, one of OS Co's customers (or a representative) could potentially be in New Zealand when OS Co made supplies under the first requirement of s GB 54.

25. In addition, TCO considered that NZ Co did not carry out an activity in New Zealand for the purpose of bringing about a particular supply under the second requirement of s GB 54. At no point did NZ Co know whether the services it provided OS Co were for a particular customer (of OS Co) or whether that customer had a physical presence in New Zealand. TCO concluded that s GB 54 would not apply to OS Co.

Issue 4 | Take tuawhā: Source under s YD 4

26. The issue was whether entering and performing the Arrangement resulted in OS Co having income that was treated as having a source in New Zealand under s YD 4.
27. In reaching its conclusion TCO considered the following elements of s YD 4:
- Whether OS Co was carrying on a business in New Zealand (s YD 4(2)).
 - Whether contracts were made or performed by OS Co in New Zealand (s YD 4(3)).
 - Whether OS Co had income through a permanent establishment (s YD 4(17C)).
 - Whether OS Co had income under a double tax agreement (s YD 4(17D)).
 - Whether OS Co were deriving income from any other source in New Zealand (s YD 4(18)).
28. TCO noted that:
- OS Co carried on a business in an overseas jurisdiction.
 - OS Co's only connection to New Zealand was that it had subcontracted NZ Co to perform services for it.
 - This in turn enabled OS Co to perform services its customers in an overseas jurisdiction.
 - OS Co did not receive or earn any payments from New Zealand under the Arrangement, nor did any of its employees perform services in New Zealand while on OS Co's payroll.
 - OS Co was paying NZ Co under the Arrangement and incurring an expense, not deriving income.
29. Therefore, TCO concluded OS Co did not derive any income from the Arrangement in New Zealand, as it was paying NZ Co to perform services for it (rather than receiving income). There was no income with a source in New Zealand for OS Co under section YD 4.

Issue 5 | Take tuarima: Assessable income under s BD 1(5)

30. The issue was whether entering and performing the Arrangement gave rise to "assessable income" for OS Co for the purposes of s BD 1(5).
31. An amount of income will not be assessable income if it is "non-residents' foreign sourced income".² "Non-residents' foreign sourced income" is an amount that:
- is foreign-sourced (it does not have a New Zealand source);
 - is derived by a non-resident; and
 - is not income of a trustee to which s HC 25(2) applies.³
32. OS Co derived "non-residents' foreign sourced income", because:
- OS Co was a non-resident of New Zealand.
 - OS Co did not derive any New Zealand sourced income under the Arrangement.
 - There was no income of a trustee to which s HC 25(2) applies. Section HC 25(2) applies to trusts with a New Zealand settlor and a non-resident trustee.
33. Therefore, TCO considered that OS Co would not have "assessable income" under s BD 1(5). Entering and performing the Arrangement did not give rise to "assessable income" for OS Co under s BD 1(5).

Issue 6 | Take tuaono: Section BG 1

34. The issue was whether s BG 1 applied to the Arrangement.
35. Section BG 1(1) provides that a "tax avoidance arrangement" is void as against the Commissioner. The approach to s BG 1 was settled by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289, which has been followed in subsequent judicial decisions.
36. TCO's approach in making this decision is consistent with Interpretation statement: *IS 23/01 Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007* (3 February 2023) (IS 23/01). IS 23/01 is not replicated in this TDS but in summary the steps are as follows:
- Understanding the legal form of the arrangement. This involves identifying and understanding the steps and transactions that make up the arrangement, the

² Section BD 1(5).

³ Section BD 1(4).

commercial or private purposes of the arrangement and the arrangement's tax effects.

- Determining whether the arrangement has a tax avoidance purpose or effect. This involves:
 - Identifying and understanding Parliament's purpose for the specific provisions that are used or circumvented by the arrangement.
 - Understanding the commercial and economic reality of the arrangement as a whole by using the factors identified by the courts.
 - Considering the implications of the preceding two steps and answering the ultimate question under the Parliamentary contemplation test: Does the arrangement, when viewed in a commercially and economically realistic way, make use of or circumvent the specific provisions in a manner consistent with Parliament's purpose?
- If the arrangement does have a tax avoidance purpose or effect, consider the merely incidental test.

37. Taking into account all of the relevant facts and circumstances (noting that as this is a summary it may not contain all the facts or assumptions relevant to the decision and, therefore, cannot be relied on) TCO concluded as follows.

The "arrangement"

38. An arrangement is defined widely and includes enforceable contracts, unenforceable understandings, and all steps and transactions carrying the arrangement into effect.⁴ TCO considered this involved the steps outlined above at [1]-[2], which include:

- OS Co engaging NZ Co to undertake work in New Zealand.
- Some of OS Co's employees taking a leave of absence from OS Co, temporarily moving to New Zealand, and being employed directly by NZ Co on fixed term contracts.
- OS Co paying NZ Co a fee on a costs plus basis for services.

Tax Effects

39. TCO considered that the Arrangement would give rise to the following tax effects:

⁴ Section YA 1 of the Act.

- NZ Co was taxable in New Zealand on its profit from the Arrangement.
- Entering and performing the Arrangement would not result in OS Co deriving any assessable income in New Zealand. This was because OS Co did not have a permanent establishment in New Zealand, were not resident in New Zealand and did not derive any New Zealand sourced income.

Whether the arrangement has a tax avoidance purpose or effect

40. TCO concluded that s BG 1 did not apply to the Arrangement because the Arrangement did not have a tax avoidance purpose or effect. A key consideration was that OS Co did not have assessable income in New Zealand as:
 - It did not have a permanent establishment in New Zealand.
 - It was not a resident in New Zealand.
 - It did not derive any New Zealand sourced income.
41. Further, NZ Co derived assessable income under the subcontract by performing activities in New Zealand on a cost-plus basis.
42. TCO considered that the Arrangement made use of the relevant provisions in a manner that is consistent with Parliament's purpose for those provisions.
43. Therefore, it was not necessary for TCO to consider the merely incidental test.