



PERMANENT ESTABLISHMENT IN NEW ZEALAND: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

Non-residents that are resident in a jurisdiction with which New Zealand has a double tax treaty agreement (DTA) are generally exempt from New Zealand income tax in respect of any business profits derived from New Zealand, provided there is no permanent establishment (PE) in NZ.

Article 5 of most of NZ's DTA's defines what is considered to be PE, and the concept generally relates to the foreign enterprise having a fixed place of business in NZ through which its business operations are wholly or partly carried on. The definition commonly includes, but is not limited to, a place of management, a branch, an office, or a factory.

The PE definition is often extended to include scenarios where the foreign enterprise is performing services in NZ through an individual who is present in NZ for more than 183 days or in respect to one project or a series of connected projects exceeding that timeframe.

Finally, often where a dependent agent of the foreign enterprise has an authority to substantially negotiate or conclude contracts in NZ, a PE will be deemed to exist in NZ.

Article 5 also lists several exclusions from the PE definition, including but not limited to:

- the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

For non-residents who reside in a jurisdiction with which NZ does not have a DTA, it is likely that the DTA PE definitions are still likely to be considered in the first instance, when determining whether or not a NZ PE exists.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

From a NZ perspective, a branch is often viewed as a foreign enterprise undertaking its operations in NZ through a PE. There is no legal separation between the foreign enterprise and its NZ branch operation. In other words, it is seen to be one single trading entity, undertaking its business activities in more than one jurisdiction.

A NZ subsidiary however is viewed as being a separate legal identity to its foreign parent company. Often the subsidiary will be a NZ company, specifically established to undertake the NZ business operations.

TAX AND ACCOUNTING OBLIGATIONS

Regardless of whether a branch or subsidiary structure is used, NZ income tax will be imposed on any income deemed to have been sourced from NZ, although such taxation may be restricted via the application of any relevant DTA provision.



DOING BUSINESS IN NEW ZEALAND

Where a branch structure is used, the foreign enterprise will need to file a NZ income tax return annually in respect to any profit attributable to the NZ branch operation. Since the branch and the foreign enterprise are one of the same, there is limited ability under a branch structure to reduce the NZ profit through utilising various transfer pricing mechanisms, such as royalties fees for use of the enterprises intellectual property rights, interest charges on capital used to finance the NZ operation or management fees charged on a cost plus basis.

A subsidiary structure can utilise such transfer pricing strategies although robust transfer pricing documentation should be prepared in this regard, as the NZ IRD is clearly focused on mechanisms such as these being used by foreign enterprises to limit the level of NZ income taxes paid. The subsidiary must also file an annual NZ income tax return.

The profit of either structure is taxed at the company tax rate of 28%.

Under a branch scenario, the 28% is a final tax on the profit and what then happens to the tax paid profit in the foreign jurisdiction is of no interest to the NZ IRD.

Under a subsidiary structure however, any distribution of the tax paid profit during the lifetime (pre liquidation) of the company is considered to be a dividend. Where the shareholders are NZ residents, a resident withholding tax of 5% must be deducted from the dividend at the time of payment and paid to the IRD. Where the shareholders are non resident, non resident withholding tax at a rate between 0% and 33% must be deducted at the time of payment and paid to the IRD (rate dependent on number of factors).

Annual financial statements are, as a matter of course, prepared for NZ company's, although depending on whether the branch or subsidiary is "large" (as defined) will determine the exact nature of the financial statements that are required to be prepared, whether they are required to be audited and whether they are required to be filed with the NZ Companies Office. In addition, the nature and size of the trading entity will determine what level of NZ financial reporting standards must be applied in the preparation of any financial statements.

REGISTRATION FORMALITIES

An overseas company can set up a branch in New Zealand as long as it registers with the NZ Companies Office on the overseas company register within 10 working days of commencing business in New Zealand.

Incorporation of a NZ subsidiary company can be completed by following the process outlined on the NZ Companies Office website (<https://www.business.govt.nz/companies/>) for incorporating a company. This process involves initially seeking name approval for the NZ company, and once obtained, filing various incorporation documents such as director and shareholder consents. A NZ company must have a NZ registered office and address for service, and there must be at least one NZ resident director or alternatively one Australian resident director who is also a director of an Australian company.

Registration for various NZ taxes such as income tax and GST, can be completed via the IRD website (<http://www.ird.govt.nz/>).

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

An overseas company that operates a NZ branch must file separate audited financial statements, with the NZ Companies' Office, in respect of both the entity itself and the NZ branch operation, if it is a "large" overseas company. These must be filed within 5 months after balance date each year. Large is defined as having any two of the following: total assets of more than NZ\$20million, revenue of more than NZ\$10million per year or more than 50 employees.