GREENMOUNT ADVISORY

19 April 2024

Assistant Secretary
Corporate and International Tax Division
Treasury
Langton Crescent
Parkes ACT 2600

By email: taxtreatiesbranch@treasury.gov.au

Dear Assistant Secretary

Submission on the expansion of Australia's tax treaty network

GreenMount Advisory Pty Ltd (ABN 93 654 885 275) welcomes the opportunity to consult with the Treasury on the proposed Expansion of Australia's tax treaty network.

GreenMount Advisory is an independent accounting firm operating in Australia and New Zealand with offices in Sydney, Auckland and Christchurch. We specialise in providing fund structuring and transaction tax advisory services. Our client base mainly consists of asset managers, their portfolio companies and sophisticated investors (e.g. family offices, superannuation funds).

Our focus is on the *Convention between Australia and New Zealand for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* ("**Australia – NZ DTA**"). In particular, we seek to make submissions in relation to the following issues:

- The ability to access the 0% withholding tax rate for dividends on unimputed / unfranked dividends where the entity is at least 80% owned by a shareholder in the other country under Article 10 (Dividends) of the Australia – NZ DTA;
- Clarification on the availability of Article 7 (Business Profits) in the context of an Australian Private Equity entity disposing of a NZ business or shares in an NZ business held on revenue account; and
- The ability for Australian managed investment trust ("**MIT**") to be viewed as a beneficial owner in its own right (without regard to its unitholders or ultimate indirect owners of its direct unitholders) under Article 4 (Resident) of the Australia – NZ DTA. Alternatively, if this submission is not accepted, provide clarification around the application of this Article in relation to the tax residence of a MIT that receives income arising in New Zealand.

Our detailed submissions are outlined in **Appendix A** of this submission.

All legislative references in this submission are to the Australia – NZ DTA, *Income Tax Assessment Act 1997* (Cth) ("**ITAA97**"), the *Income Tax Assessment Act 1936* (Cth) ("**ITAA36**"), or the Income Tax Act 2007 ("**ITA07(NZ)**") in the context of New Zealand tax law, unless otherwise stated.

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Thank you for the opportunity to make a submission. If you have any questions in relation to our submission or would like to discuss our submission, please contact any member of our GreenMount Advisory team.

Yours sincerely

GreenMount Advisory

Ryan Davis | Executive Chairman
+61 (0) 428 977 492
Ryan.davis@greenmount.com

Lachlan Maguire | Managing Director
+61 (0) 412 187 844
Lachlan.maguire@greenmount.com

Chris Monsted | Managing Director
+61 (0) 418 412 308
Chris.monsted@greenmount.com

Len Nicita | Managing Director
+61 (0) 449 060 065
Len.nicita@greenmount.com

Submission One: Availability of a 0% Dividend Withholding Tax Rate for an unlisted company

Article 10 – Dividends

This Article sets out the relevant non-resident withholding tax rates for dividends paid to non-residents.

Broadly, the non-resident withholding tax ("**NRWT**") rate for dividends is capped at 15%. However, this rate may be reduced to 5%, where the beneficial owner of those dividends is a company that holds directly at least 10% of the voting interests in the company paying the dividends, or to 0%, in some other cases (discussed below).

0% non-resident withholding tax rate

Paragraph 3 of Article 10 of the Australia – NZ DTA allows the NRWT rate for dividends to be reduced to 0% where:

- The beneficial owner of the dividends is a company that owns 80% or more of the voting interests of the company paying the dividends;
- The company receiving the dividends has owned the shares in the company paying the dividends for a 12 month period ending on the date the dividend is declared; and
- The company receiving the dividends is a listed company (or owned directly or indirectly by one or more companies that is listed).
  - Alternatively, the company does not meet the listed company requirement but has obtained approval an exemption from a competent authority.

For completeness, a 0% NRWT rate is already generally available in respect of franked / imputed dividends paid to an offshore shareholder under domestic Australian[1] and New Zealand law.[2] Therefore Article 10 of the Australia – NZ DTA is primarily relevant for unfranked / unimputed dividends.

Comment and recommendation

Paragraph 3 of Article 10 of the Australia – NZ DTA allows for listed companies receiving unfranked / unimputed dividends to access the 0% NRWT rate by virtue of meeting the relevant criteria. However, unlisted companies are required to obtain an exemption from a competent authority in order to achieve the same benefits.

In our view, this appears to be less favourable than the double tax agreements that are currently in place between Australia and the United States, and between New Zealand and the United States (together, "**United States DTAs**"). In both United States DTAs, unlisted

[1] See section 128B(ga)(i) ITAA36
[2] See section RF 11B ITA07(NZ)

companies have the ability to access the 0% NRWT rate by virtue of having 80% or more of the voting interests in the company paying the dividend for a 12 month period ending on the date the dividend is declared, provided the relevant criteria under Article 16 (Limitation on Benefits) have been met.

It is acknowledged that Paragraph 2(c)(i) and 2(c)(ii) of Article 16 (Limitation on Benefits) for both the United States DTAs contains a similar listed company requirement (i.e. the company receiving the dividend must be listed or a be a subsidiary of a listed company, respectively). However, there are other tests, such as the test in paragraph 2(e) of the NZ – US DTA or paragraph 2(g) of the Australia - US DTA in relation to the 'ownership' and 'base erosion' tests and paragraph 3 of each of the United States DTAs in relation to the 'active trade or business' test that allow the company receiving the dividend to make a self-assessment to determine whether the relevant criteria applies rather than having to make an application to a competent authority for an exemption.

The ability to make a self-assessment for unlisted companies under the United States DTAs without having to engage with a competent authority appears to be more favourable than Paragraph 3 of Article 10 (Dividends) of the Australia – NZ DTA as competent authority engagement can sometimes be a time consuming and costly, especially for smaller taxpayers, i.e. with fewer temporal and monetary resources than a typical listed company.

Given the economic and international trading relationship between Australia and New Zealand, we recommend that Article 10 the Australia – NZ DTA should be at least as favourable as the United States DTAs with the respective countries to enable an opportunity for unlisted companies that own 80% or more in a company paying dividends to access the 0% NRWT rate without having to make an application to a competent authority for an exemption.

Submission Two: Clarification on the availability of Article 7 (Business Profits) of the Australia – NZ DTA in the event an Australian Private Equity entity disposes of an NZ business or shares in a NZ business held on revenue account

Disposal of shares held on capital account in New Zealand

The tax treatment of a disposal of a New Zealand asset (including shares in a company) depends on whether the asset is held on revenue account or capital account.

To the extent an asset is held on capital account, any gain arising on the sale of that asset should be a capital gain, which is non-taxable and therefore should not give rise to any taxable income in New Zealand (because New Zealand does not have a comprehensive capital gains tax regime).

Article 13 (Alienation of Property) of the Australia – NZ DTA

In respect of a resident of Australia who derives a capital gain from the disposal of a New Zealand asset, Paragraph 5 of Article 13 (Alienation of Property) of the Australia – NZ DTA provides that capital gains arising to a resident of Australia from the disposal of a New Zealand asset should be taxable in Australia only:

> *Gains of a capital nature from the alienation of any property, other than that referred to in the preceding paragraphs, shall be taxable only in the Contracting State of which the alienator is a resident.*

This tax treatment is further subject to Paragraphs 1-4 of Article 13 (Alienation of Property) of the Australia – NZ DTA.

Most importantly, this Article only applies where a gain is of a capital nature (i.e. the disposed asset was held on capital account), and therefore is not applicable where the disposed asset was held on revenue account.

Disposal of shares held on revenue account

A taxpayer will generally be considered to hold an asset (including shares in a business) on revenue account for New Zealand income tax purposes where one of the following is satisfied:

- The taxpayer acquired the property as part of carrying on a profit making scheme or undertaking;[3]
- The taxpayer acquired the asset with the dominant purpose of disposing of the asset;[4] or

[3] See section CB 3 ITA07 (NZ)
[4] See section CB 4 ITA07 (NZ)

- The taxpayer carries on a business in dealing with property of that kind.[5]

If an Australian private equity entity disposes of shares in an NZ company on revenue account, and a taxable revenue gain is made, there is a risk that both Australia and New Zealand have rights to taxation this revenue gain, unless relief is available under the Australia – NZ DTA.

As noted above, relief under the Article 13 (Alienation of Property) of the Australia – NZ DTA is only available where a capital gain has been made and therefore would not be relevant if the disposed asset was held on revenue account.

Article 7 (Business Profits) of the Australia – NZ DTA

Paragraph 1 of Article 7 (Business Profits) of the Australia – NZ DTA provides that any profits of an Australian enterprise will only be taxable in New Zealand to the extent the profits are attributable a permanent establishment in New Zealand:

> *The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.*

Comment and Recommendation

At the date of this submission, there has been no guidance released by the New Zealand Inland Revenue as to whether revenue gains from the disposal of shares by a private equity fund entity could constitute "business profits". Therefore, it is unclear whether Article 7 (Business Profits) of the Australia – NZ DTA would apply in the context of a non-NZ-resident entity recognising a gain from the disposal of shares held on revenue account.

From an Australian perspective, the Australian Taxation Office has clearly stated its view that revenue gains from the disposal of shares by a private equity fund entity constitutes business profits, and that the relevant 'business profits article' of a tax treaty should apply to determine the country with the taxing rights generally. We refer, for instance, to *Tax Determination TD 2010/21* which states that:

- The sale of Australian shares by a foreign private equity entity can be included as the assessable income under section 6-5 of the ITAA97 (equivalent to section CA 1 (2) of the ITA07(NZ)) where the profit is income according to ordinary concepts;[6] and
- Where a private equity entity that has acquired shares in an Australian company is a resident of a country with which Australia has a tax treaty, the business profits

[5] See section CB 5 ITA07(NZ)

[6] Paragraph 1 of Tax Determination TD 2010/21.

article will determine which country has the taxing rights in respect of any profit that is of an income nature. It is generally the case that the country of residence of the profit maker will be entitled to tax those profits. Accordingly, non-Australian private equity entities in treaty countries will not usually be subject to tax on their Australian sourced business profits.[7]

We submit that it would be desirable for the interpretation as to what constitutes "business profits" to be consistent between the respective Australian and New Zealand tax authorities. To that end, we submit that sufficient guidance should be included in the Explanatory Memorandum that encompasses any revisions to the Australia – NZ DTA that confirms Article 7 (Business Profits) can apply to revenue gains from the disposal of assets held on revenue account (i.e. consistent with the Australian tax authority's interpretation). This could be achieved, for example, by including an example of a New Zealand private equity fund entity making a revenue gain from the sale of an Australian portfolio company.

Given MITs are already contemplated in Article 4 of the current Australia – NZ DTA, we recommend that it is explicitly stated that gains arising from the disposal of 'covered assets' made by an Australian MIT that has made a 'capital account election' for Australian domestic law purposes are deemed to be of a capital nature for the purposes of Article 7 (Business Profits) and Article 13 (Alienation of Property) of the Australia – NZ DTA.

We also submit that there may be further stimulation of mutual investment between the contracting states and reduction in legislative complexity if gains made by superannuation funds or entities established under the Australian Venture Capital Act (or New Zealand equivalent) such as Early Stage Venture Capital Limited Partnerships, Venture Capital Limited Partnerships, Australian Fund of Funds were similarly deemed to be of a capital nature for the purposes of Article 7 (Business Profits) and Article 13 (Alienation of Property) of the Australia – NZ DTA.

[7] Paragraph 3 of Tax Determination TD 2010/21.

Submission Three: Residency of MITs under Article 4 of the Australia – NZ DTA

Article 4 – Resident

This Article sets out how the residence of an entity is to be determined for the purposes of the Australia – NZ DTA. An entity must be a resident of either Australia or New Zealand in order to obtain any benefits available under the Australia – NZ DTA.

Managed Investment Trusts ("MITs")

A MIT is a type of Australian trust. It is typically used as a collective investment vehicle to invest in passive investments, such as shares, property or fixed-interest bearing assets.

The definition of a MIT for the purposes of the Australia – NZ DTA is the definition under Australia tax law[8].

Under Australian domestic tax law, MITs are treated as fiscally transparent entities.

However, under New Zealand tax law, a MIT is treated as a company because it is a unit trust[9] (i.e. stand-alone, fiscally opaque taxpayer).

Application of Article 4 to MITs

Paragraph 7 of Article 4 provides the following in relation to the residence of Managed Investment Trusts for the purposes of the Australia – NZ DTA:

> *Notwithstanding the other provisions of this Convention, a managed investment trust which receives income (including profits and gains) arising in New Zealand shall be treated, for the purposes of applying the Convention to such income, as an individual resident of Australia and as the beneficial owner of the income it receives, but only to the extent that residents of Australia are the owners of the beneficial interests in the managed investment trust. However, if:*
>
> *(a) the managed investment trust has its principal class of units listed on a stock exchange specified in subsubparagraph 1 l)(i) of Article 3 and is regularly traded on one or more recognised stock exchanges; or*
> *(b) at least 80 per cent of the value of the beneficial interests in the managed investment trust is owned by residents of Australia,*
>
> *the managed investment trust shall be treated as an individual resident of Australia and as the beneficial owner of all the income it receives.*

[8] Paragraph 1m) of Article 3 (Definitions) of the Australia – NZ DTA
[9] See the definition of "Company" under section YA 1 of the ITA07(NZ)

Comment and Recommendation

In our view, it is unclear how the provision "*only to the extent residents of Australia are the owners of the beneficial interests in the managed investment trust*" should be interpreted to determine the identity of the "owners of the beneficial interests" in a MIT. In particular, where the unit holders of a MIT are not individuals, it is unclear whether it is the immediate unitholder or ultimate indirect owner of the units who should be considered as the beneficial owner. The Australian explanatory memorandum to the Australia – NZ DTA[10] does not provide any commentary on this matter.

If this provision requires the MIT to identify the ultimate indirect owner of the units, this will create undue compliance costs. In our experience, this matter affects many MITs, especially smaller MITs that may not have sufficient temporal or monetary resources to deal with these compliance requirements in an economic manner. For example, in the Australian mid-market private equity space, many funds have a mandate to invest in both Australian and New Zealand businesses. These funds would typically have assets under management of AUD200m-AUD500m only, resulting in a small team of employees only being available to manage the fund. Further, many of these MITs would have raised equity from funds-of-funds, which in turn may have many foreign investors comprising a range of different types of foreign corporate or fund entities. At the date of our submission, there is no definitive list of non-Australian entities published by either Australian Treasury or the Australian Taxation Office that concludes on the Australian tax status of non-Australian entities. It would therefore be unduly burdensome for the manager of the MIT to analyse and conclude on the tax status of each ultimate investor for the purposes of the Australian – NZ DTA.

To address this difficulty, we propose that the Australia – NZ DTA is able to be interpreted such that a MIT is viewed as a beneficial owner in its own right, irrespective of its unitholders or ultimate indirect owner of its units. In other words, we propose that a MIT is treated as a company under the Australia – NZ DTA, in the same way that it would be treated as a company under New Zealand domestic tax law.

If this recommendation is not accepted, we submit that further guidance is provided in respect of Paragraph 7 of Article 4 of the Australia – NZ DTA in relation to whether consideration should be given to the immediate unitholder or the ultimate indirect owner of its units when considering whether the owner of the beneficial interests in a MIT are Australian residents.

It would also be helpful if an example scenario is included in any future explanatory memorandums that considers the application of this Article for determining the owners of beneficial interests in a MIT.

[10] International Tax Agreements Amendment Bill (No 2) 2009

We recommend consideration is also given to extending the application of Article 4 in relation to MITs to entities established under the Australian Venture Capital Act (or any New Zealand equivalent).