Introduction

This is the final version of the special report on transfer pricing rules for base erosion and profit shifting (BEPS).

The rules were enacted on 27 June 2018 in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

This special report was also published in the April 2019 edition of the Tax Information Bulletin (Volume 31 Number 3).

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Summary of amendments

Transfer pricing rules guard against multinationals using related-party arrangements to shift profits offshore by requiring the profits from these arrangements to be determined using the arm’s length conditions, including price, which unrelated parties would agree to use.

Sections GC 6 and GC 13 have been amended to strengthen the transfer pricing rules so they align with the OECD’s transfer pricing guidelines and Australia’s transfer pricing rules.

Application date

The amendments to the transfer pricing rules generally apply from income years beginning on or after 1 July 2018.

Arrangements that comply with an Advance Pricing Agreement issued by the Commissioner of Inland Revenue before 1 July 2018 will be grand-parented so they remain subject to the old transfer pricing rules until the Advance Pricing Agreement expires.

Key features

The Act makes the following amendments to New Zealand’s transfer pricing legislation:

• In addition to applying to transactions between associated persons, the transfer pricing rules will also apply when there are transactions between members of non-resident owning bodies and companies, and to cross-border related borrowings. (Section GC 6(2)(b))

• Including a reference to using the 2017 OECD transfer pricing guidelines as guidance for how the transfer pricing rules are applied. (Section GC 6(1B))

• The economic substance and actual conduct of the parties, along with the legal contract, will inform the transfer pricing analysis. In certain circumstances, the economic substance and actual conduct will have priority over the terms of the legal contract. This is achieved by requiring the transfer pricing transaction to be “accurately delineated” using the approach in section D.1 of chapter I of the 2017 OECD transfer pricing guidelines. (Section GC 13(1B))

• Where a transfer pricing arrangement is not commercially rational because it includes unrealistic terms that unrelated parties would not be willing to agree to, the approach described in section D.2 of chapter I of the new OECD guidelines may apply to disregard and, if appropriate, replace the transaction. (Section GC 13(1C))

• Requiring the arm’s length amount of consideration to be determined using arm’s length conditions. This clarifies that it may be necessary to adjust some conditions of the arrangement other than the price, in order to determine the arm’s length price. (Section GC 13(1)(b))

• Placing the onus of proof onto the taxpayer for providing evidence (such as transfer pricing documentation) that their transfer pricing positions are correct (that is, they are determined using arm’s length conditions). The general onus of proof in section 149A(2)(b) of the Tax Administration Act 1994 will now apply to transfer pricing as well as other tax matters.
• The time bar that limits Inland Revenue’s ability to adjust a taxpayer’s transfer pricing position can be increased to seven years, in those cases where the Commissioner of Inland Revenue has notified the taxpayer that a tax audit or investigation has commenced within the usual four-year time bar. (Section GC 13(6))

Background

The OECD’s transfer pricing guidelines were substantially updated in 2017 as part of the OECD’s BEPS project. The updates to chapter I of the guidelines were designed to align transfer pricing outcomes with value creation (BEPS Actions 8–10). The OECD has noted that the new guidance ensures that:

• actual business transactions undertaken by associated enterprises are identified, and transfer pricing is not based on contractual arrangements that do not reflect economic reality;
• contractual allocations of risk are respected only when they are supported by actual decision-making;
• capital without functionality will generate no more than a risk-free return, assuring that no premium returns will be allocated to cash boxes without relevant substance; and
• tax administrations may disregard transactions which are commercially irrational.

The Act amends New Zealand’s transfer pricing legislation to ensure New Zealand’s legislation aligns with the new OECD transfer pricing guidelines and that our rules remain effective at combatting BEPS.

Other changes have been made to strengthen Inland Revenue’s ability to monitor and enforce the new transfer pricing rules. These changes include:

• Putting the onus of proof onto the taxpayer for providing evidence (such as documentation) that their transfer pricing positions are correct (that is, they are determined using arm’s length conditions).
• Allowing Inland Revenue to extend the time bar for assessing transfer pricing issues to seven years, in those cases where Inland Revenue has notified the taxpayer that a tax audit or investigation has commenced within the usual four-year time bar.
• Amendments to the Tax Administration Act 1994 to provide Inland Revenue with additional powers to request information from large multinational groups in order to assist a tax investigation of the relevant multinational. These information changes are explained in the special report on administrative measures (see the section on “Requesting information from large multinational groups”).
Detailed analysis

**GC 6(1): Purpose of the transfer pricing rules**

The purpose of the transfer pricing rules is to substitute an arm’s length amount of consideration if a person’s net income has been reduced by the conditions of a cross-border arrangement with a related party.

The purpose statement in section GC 6(1) has been updated so it refers to the special rules for pricing cross-border related borrowing as well as the general transfer pricing rules for pricing the acquisition or supply of goods, services, or anything else.

This reflects the fact that the transfer pricing rules now include some special rules for determining how cross-border related borrowing is priced. These rules are in sections GC 6(3B) and GC 15 to 19 and require certain adjustments to be made to the credit rating of the borrower and conditions of the financial arrangement, prior to the general transfer pricing rules in sections GC 6 to GC 14 being used to price the adjusted financial arrangement.

The special rules for cross-border related borrowing are explained in the special report on interest limitation (see the section on “Cross-border related borrowing”).

**GC 6(1B): Applying the OECD transfer pricing guidelines**

New Zealand has contributed to and applied the OECD’s transfer pricing guidelines since they were first published in 1995. As transfer pricing practices have become more sophisticated, the OECD through its BEPS work has updated its guidelines to represent the agreed international best practice.

Subsection GC 6(1B) has been added so that New Zealand’s transfer pricing legislation explicitly refers to the OECD transfer pricing guidelines by requiring the transfer pricing rules in sections GC 6 to GC 14 to be applied consistently with these guidelines.


The general policy intention is that when a taxpayer has correctly applied the OECD transfer pricing guidelines to perform a transfer pricing analysis that demonstrates that their transfer pricing positions satisfy the arm’s length principle, they should have a reasonable degree of certainty that these tax positions will also meet the requirements of New Zealand’s transfer pricing rules.

However, the guidelines still need to be applied in conjunction with New Zealand’s legislation as there are some specific rules in New Zealand’s legislation which are additional to the guidance material in the OECD transfer guidelines.

For example, the OECD transfer pricing guidelines were developed to provide guidance for how to apply Article 9 of the OECD model double tax agreement to “associated enterprises” as
defined in that Article. New Zealand’s transfer pricing legislation applies to a wider range of cross-border related party arrangements (as is further explained in section GC 6(2)(b) below).

Another area where New Zealand’s transfer pricing rules are more prescriptive is that New Zealand’s legislation has special rules that must be used for determining how cross-border related borrowing is priced. These rules are in sections GC 6(3B) and GC 15 to 19 and can require certain adjustments to be made to the credit rating of the borrower and conditions of the financial arrangement, prior to the general transfer pricing rules in sections GC 6 to GC 14 (and the OECD transfer pricing guidelines) being used to price the adjusted financial arrangement.

The application date for new section GC 6(1B) is income years beginning on or after 1 July 2018. This means transfer pricing positions taken on or after 1 July 2018 must be analysed in a way that is consistent with the July 2017 version of the OECD transfer pricing guidelines.

The July 2017 version of OECD guidelines, or later updates to the guidelines may also be relevant for analysing tax positions taken before 1 July 2018 to the extent that they are not inconsistent with New Zealand’s domestic law at that time (in sections GC 6 to GC 14).

The OECD transfer pricing guidelines are periodically updated by the OECD and New Zealand participates in developing the updated guidelines. When these updates occur, New Zealand will consider the revisions to the guidelines with a view to updating the definition of the OECD transfer pricing guidelines in section YA 1 so it refers to the latest version of the guidelines. Future taxation bills would be used to include these updates to the definition in section YA 1.

If a future taxation Act updates the definition of the OECD transfer pricing guidelines to refer to a newer version of the guidelines, the rules must be applied in a way that is consistent with the new version of the guidelines from the date that the new Act applies.

However, when the relevant updates to the OECD guidelines are not inconsistent with New Zealand’s domestic law, the latest version of the guidelines may also be relevant in analysing tax positions from a period prior to the guidelines being updated. This is because in most cases updates to the guidelines will clarify or provide further guidance on existing concepts, rather than introducing significant new concepts or practices. In this regard applying the latest version of the OECD’s transfer pricing guidelines can aid with the application and interpretation of transfer pricing legislation that was enacted earlier. Inland Revenue and many taxpayers routinely apply the latest versions of the guidelines to assist in analysing cases from earlier years, as the latest guidelines are generally consistent with our existing law.

**GC 6(2)(b): Defining the related party arrangements to which the transfer pricing rules apply**

Section GC 6(2) defines the transfer pricing arrangements that the transfer pricing rules apply to. A transfer pricing arrangement is a cross-border arrangement between related parties.

The meaning of “arrangement” (which is described in section GC 6(2)(a)) and “cross-border arrangement” (which is defined in section GC 6(3)), are unchanged under the new legislation.

However, the concept of “related party” has been expanded under the new legislation.
Prior to July 2018, the transfer pricing rules only applied to arrangements between “associated persons” as defined in section YA 1. For example, two companies are associated persons if they have fifty percent or more common ownership.

The new rules apply to cross-border arrangements between:

- associated persons (as defined in section YA 1);
- a company and a member of a non-resident owning body where the members of the non-resident owning body collectively have voting or market value interests in the company of fifty percent or more; and
- a non-resident (lender) and another person (borrower) that includes a financial arrangement that is a cross-border related borrowing (as defined in GC 6(3)).

Associated persons

Associated persons are defined in section YA 1 of the Income Tax Act 2007.

The definition of “associated persons” is unchanged by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018. This means the set of “associated persons” who were required to apply the transfer pricing rules prior to 1 July 2018, will continue to be subject to the transfer pricing rules after 1 July 2018 (assuming they continue to meet the definition of “associated persons” in section YA 1).

Some typical cases where persons are associated include:

- Two companies, where the same group of persons own fifty percent or more of the voting interests, market value interests or control by other means in both of the companies.
- When a person who is not a company owns twenty five percent or more of the voting interests or market value interests of the company.
- A limited partnership and a partner when the partner owns twenty five percent or more in a right, obligation, or other property, status or thing of the limited partnership.
- A non-limited partnership and a partner in the partnership.
- Natural persons who are close relatives.

Many of these tests also include aggregation rules whereby if two persons are associated under another rule their interests are aggregated for determining whether the relevant voting, market value or control thresholds are met. So, for example if a mother owns more than fifty percent of one company and her daughter owns more than fifty percent of another, the companies would be associated with each other.

Non-resident owning bodies

Section GC 6(2)(b) extends the application of the transfer pricing rules so they also apply when the transfer pricing arrangement is between a company and a person who is a member of a non-resident owning body that has at least fifty percent of the ownership interests in the company.

This rule is intended to capture private equity structures where it is common for a group of shareholders to co-ordinate on how to debt fund the New Zealand company. In addition to using debt funding such private equity structures can also use other arrangements such as service fees
or royalties to shift profits out of New Zealand in order to reduce the overall tax paid on their investments. The extension of the application of the transfer pricing rules to non-resident owning bodies means that the transfer pricing rules will apply to both debt and non-debt transactions that members of these non-resident owning bodies have with companies in New Zealand.

The concept of a “non-resident owning body” is defined in section YA 1. It is used in the non-resident withholding tax (NRWT) rules as an interest payment to a member of a non-resident owning body is not eligible for a 0% rate of NRWT (when the approved issuer levy has been paid by the borrower). The concept is also used for determining whether the thin capitalisation rules apply as companies which are controlled by a non-resident owning body are subject to thin capitalisation rules.

This means that the transfer pricing rules will generally apply to the same set of companies and non-resident investors as the thin capitalisation rules and the NRWT rules for related party interest payments.

A non-resident owning body is a group of non-residents or entities (such as trusts settled by non-residents), that have one or more characteristics indicating they are acting together to debt-fund a New Zealand company. These characteristics include:

- having proportionate levels of debt and equity among the group. Proportionality is a characteristic of acting together as it generally requires a degree of coordination to achieve;
- having an agreement that sets out how the company should be funded with an arrangement between the members of the group concerning debt if the company is not widely held. Widely held is defined in section YA 1 and means a company has at least 25 shareholders (counting any associated shareholders as one shareholder) and is not controlled by five or fewer of these shareholders; and
- having an arrangement between the members of the group concerning debt in the company in a way recommended by a person (such as a private equity manager), or implemented on behalf of the members.

Because the definition of a non-resident owning body requires the shareholders to hold debt in the company in proportion to their shareholding or for the relevant agreement or arrangement to be a co-ordinated debt funding arrangement, the transfer pricing rules should not apply simply because a company has a typical shareholder’s agreement setting out how shareholders agree to exercise their individual shareholder rights.

Ownership interest is defined in YA 1 to mean voting or market value interests. Therefore if the group of members in the non-resident owning body collectively own fifty percent or more of the voting or market value interests of the company, the transfer pricing rules will apply to all debt and non-debt arrangements between the company and a member of the non-resident owning body.

**Cross-border related borrowings**

The application of the rules also specifically includes cross-border related borrowings subject to the new transfer pricing rules for debt arrangements.
A cross-border related borrowing is defined in section GC 6(3B). This definition is further explained in the special report on interest limitation (see the section on “Cross-border related borrowing”).

**GC 7 to GC 12**

Sections GC 7 to GC 12 are unchanged under the new legislation. These sections go through the various cases where the amount of consideration is substituted with an arm’s length amount of consideration because a person’s net income has been reduced by the conditions of a cross-border arrangement with a related party.

**GC 13(1): Determining arm’s length amounts**

Section GC 13(1) outlines the process for determining an arm’s length amount of consideration.

This is the amount of consideration that independent parties after real and independent bargaining would have agreed upon as the price for the identified transaction if the identified transaction had occurred under arm’s length conditions.

**Identifying the related party transaction**

The first step is to take the transfer pricing arrangement (between the related parties) and apply section D.1 of chapter I of the OECD transfer pricing guidelines to accurately delineate the transaction.

If the accurately delineated transaction is not commercially rational so that there is no price which would be acceptable to independent parties in exchange for the relevant goods or services being supplied, the approach described in section D.2 of chapter I of the guidelines will apply, and can be used to disregard or replace the transaction.

Section GC 13(1)(a) defines the term “the identified transaction”. In most cases this will be the accurately delineated transaction found by applying section D.1 of chapter I. However, in cases where section D.2. of chapter I applies to replace the transaction, the “identified transaction” will instead be the replacement transaction.

**Comparability analysis**

In order to determine the arm’s length conditions, including the arm’s length price, the identified transaction is benchmarked against comparable transactions between independent parties. This involves the use of a comparability analysis whereby the taxpayer:

- identifies the arm’s length conditions which might be expected to be agreed between independent parties operating at arm’s length for comparable arrangements to the identified transaction; and
- uses one or more of the approved transfer pricing methods to produce the most reliable measure of the arm’s length amount of consideration that would be agreed upon as part of the arm’s length conditions.
One of the five approved transfer pricing methods (or a combination of these methods) described in chapter III of the OECD transfer pricing guidelines must be used to perform the comparability analysis.

The references in GC 13(1) to the “identified transaction” are not intended to limit the methods that taxpayers may use to perform a comparability analysis – any of the five methods listed in GC 13(2) can be used to perform this analysis.

The meaning of “identified transaction”, arm’s length conditions and “arm’s length amount of consideration” are further explained below.

**GC 13(1)(b): Arm’s length conditions**

“Arm’s length conditions” are defined in section GC 13(b) as the conditions independent parties after real and independent bargaining might be expected to agree upon for the identified transaction.

In the phrase “arm’s length conditions”, “conditions” is not a defined term in the Act but is intended to include financial values such as the price, gross margin, net profit, and the division of profit between the acquirer and supplier as well as other conditions. This is consistent with paragraph 1.7 of the 2017 OECD transfer pricing guidelines which refers to “…conditions (including prices, but not only prices).”

Conditions may also include features going beyond the financial indicators relevant in applying transfer pricing methods.

The insertion of “conditions” is intended to clarify that a wider set of features, other than the price may be relevant when considering if the conditions of the transfer pricing arrangement need to be substituted with the conditions that would apply under comparable arm’s length arrangements.

The relevant arm’s length conditions for a transfer pricing arrangement will depend on the specific facts of the arrangement. The conditions will be relevant to the extent to which independent parties would take those conditions into account when evaluating the terms of a similar arrangement. The process of accurately delineating the arrangement using section D.1. of chapter I of the OECD transfer pricing guidelines will assist in establishing which conditions are relevant.

New Zealand’s transfer pricing legislation also refers to the concept of an “arm’s length amount of consideration” (and has done so since the rules were first introduced in 1995). The Federal Court in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2015] FCA 1092* found that the term “consideration”, which was used in Australia’s transfer pricing rules at the time the disputed transaction took place, had a broader meaning than just the price (interest rate). The Federal Court agreed that the Commissioner could make adjustments to other conditions (security and loan covenants in the Chevron case), that could have an impact on the price.

This decision illustrates that the term “consideration” should also be interpreted more widely than price. The insertion of the new term “conditions” helps to clarify the existing policy of considering features in addition to price, rather than creating a different policy for pre-July 2018 and post-July 2018 tax positions.
GC 13(1B): Determination of identified transaction

The transfer pricing rules require the overall economic substance of the arrangement to be considered. The analysis is not limited to the legal contracts and takes into account the wider economic arrangement and commercial environment. In particular, if the legal contracts do not reflect the actual conduct of the parties, the actual conduct of the parties will be used to apply the transfer pricing rules.

New section GC 13(1B) achieves these outcomes by requiring the transfer pricing arrangement to be “accurately delineated using the approach described in section D.1 of chapter I of the OECD transfer pricing guidelines.”

Section D.1 of the OECD transfer pricing guidelines describes the process for accurately delineating the transaction. This process involves identifying the economically relevant characteristics. Some broad categories of the economically relevant characteristics are listed in paragraph 1.36 of the guidelines as:

- The contractual terms of the transaction (as described in section D.1.1).
- The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including:
  - how those functions relate to the wider generation of value by the multinational enterprise group to which the parties belong;
  - the circumstances surrounding the transaction; and
  - industry practices (D.1.2).
- The characteristics of property transferred or services provided (D.1.3).
- The economic circumstances of the parties and of the market in which the parties operate (D.1.4).
- The business strategies pursued by the parties (D.1.5).

As part of accurately delineating the controlled transaction, the terms of the legal agreement may be disregarded to the extent that they are inconsistent with the actual conduct of the parties. This is explained in paragraphs 1.45 and 1.46 of the OECD transfer pricing guidelines.

The OECD transfer pricing guidelines provide several examples that illustrate particular aspects of how to accurately delineate transactions. This includes examples of:

- how the terms of the written contract may be clarified or supplemented by examining the actual conduct of the parties (see paragraph 1.44);
- how to deal with differences between written contractual terms and conduct of the parties, with the result being that the actual conduct of the parties is used to accurately delineate the transaction (paragraph 1.48);
- using the conduct of the parties to identify a transaction where one has not been identified by the multinational (paragraph 1.50); and
- how risks should be assumed according to how the parties actually manage and control these risks (see paragraphs 1.83–1.85 and 1.89).
GC 13(1C): No transaction or differing transaction

Where the transfer pricing arrangements entered into are not commercially rational there is consequently no price which would be acceptable to independent parties in exchange for the relevant goods or services being supplied and acquired.

In such cases it is not possible to apply a transfer pricing analysis as transfer pricing relies on being able to identify the arm’s length price which would be agreed between independent parties.

To address this problem, section D.2 of chapter I of the OECD transfer pricing guidelines provides guidance about the circumstances where a transaction can be disregarded, and if appropriate replaced with an alternative transaction that allows for a transfer pricing analysis to be performed. These circumstances are described in paragraphs 1.122-1.125 of the OECD transfer pricing guidelines.

Accordingly, section GC 13(1C) applies when the requirements of paragraph 1.122 of the OECD transfer pricing guidelines are met. In summary, this paragraph states that the accurately delineated transaction can be disregarded and potentially replaced, if it would not be commercially rational for independent enterprises to enter into the transaction, because it would not be possible to determine a price which would be acceptable to both of the independent parties at the time that the transaction was entered into.

The full text of paragraph 1.122 of the OECD transfer pricing guidelines:

“1.122 This section sets out circumstances in which the transaction between the parties as accurately delineated can be disregarded for transfer pricing purposes. Because nonrecognition can be contentious and a source of double taxation, every effort should be made to determine the actual nature of the transaction and apply arm’s length pricing to the accurately delineated transaction, and to ensure that non-recognition is not used simply because determining an arm’s length price is difficult. Where the same transaction can be seen between independent parties in comparable circumstances (i.e. where all economically relevant characteristics are the same as those under which the tested transaction occurs other than that the parties are associated enterprises) non-recognition would not apply. Importantly, the mere fact that the transaction may not be seen between independent parties does not mean that it should not be recognised. Associated enterprises may have the ability to enter into a much greater variety of arrangements than can independent enterprises, and may conclude transactions of a specific nature that are not encountered, or are only very rarely encountered, between independent parties, and may do so for sound business reasons. The transaction as accurately delineated may be disregarded, and if appropriate, replaced by an alternative transaction, where the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a price that would be acceptable to both of the parties taking into account their respective perspectives and the options realistically available to each of them at the time of entering into the transaction. It is also a relevant pointer to consider whether the MNE group as a whole is left worse off on a pre-tax basis since this may be an indicator that the transaction viewed in its entirety lacks the commercial rationality of arrangements between unrelated parties.”
In cases where the accurately delineated transaction is replaced it should be replaced with a new transaction that enables a price that would be commercially rational for independent enterprises to agree to. As noted in paragraph 1.124 of the OECD transfer pricing guidelines, the replacement transaction should closely adhere to the facts (as accurately delineated) of the original transfer pricing transaction and only diverge from those facts to the extent that it is necessary to achieve a commercially rational outcome:

“1.124 The structure that for transfer pricing purposes, replaces that actually adopted by the taxpayers should comport as closely as possible with the facts of the actual transaction undertaken whilst achieving a commercially rational expected result that would have enabled the parties to come to a price acceptable to both of them at the time the arrangement was entered into.”

Paragraph 1.128 of the OECD transfer pricing guidelines provides an example where an arrangement is replaced. The example involves a lump sum payment for all future intangibles developed by an associated company over the next 20 years. This arrangement would not be commercially rational for independent parties to agree on as it is not possible to value these future intangibles. In this example, a number of potential replacement transactions could be considered including a financing arrangement, a contract for research services or a licencing agreement for some specific identified intangibles.

The transaction will be disregarded and not replaced if the commercially rational deal that independent parties would accept in comparable circumstances is one that involves no supply or acquisition. This is provided for by new section GC (13)(1C)(a). If the transaction is disregarded under section GC 13(1C)(a) of the transfer pricing rules it will be null and void for determining the person’s New Zealand income tax liability. Note that there may still be NRWT on the payments as existing section GC 12 means that transfer pricing adjustments do not affect NRWT obligations.

Paragraphs 1.126 and 1.127 of the OECD transfer pricing guidelines provide an example of a transaction which is disregarded and not replaced. This example involves a property prone to flooding which an independent insurer would not agree to insure as evidenced by there being no active insurance market for properties in that area.

**GC 13(2): Approved transfer pricing methods**

Section GC 13(2) requires the taxpayer to determine the arm’s length amount of consideration under arm’s length conditions by performing a comparability analysis as required by the OECD transfer pricing guidelines, chapter III, using any one or a combination of the five transfer pricing methods that are described in chapter II of the OECD transfer pricing guidelines.

The choice of method that should be used is the method (or combination of methods) which produces the most reliable measure of the arm’s length amount of consideration (see section GC 13(1)(c)). Chapter II of the OECD transfer pricing guidelines includes some further guidance on what transfer pricing method should be used, depending on the relevant circumstances of the arrangement and data availability.

The requirements under the updated section GC 13(2) are very similar to requirements under the previous section GC 13(2) of the Income Tax Act 2007. The main differences are that the names of the transfer pricing methods have been updated to the modern terminology and the
updated provision now refers to using the OECD guidelines as guidance for how to perform a comparability analysis using the methods described in those guidelines.

In addition to the guidance in chapter III of the OECD transfer pricing guidelines, there is some relevant guidance on the factors that a comparability analysis should take into account in section D.1 of chapter I of the OECD guidelines.

In particular, paragraph 1.39 of the OECD guidelines notes that “differences in economically relevant characteristics between the controlled and uncontrolled arrangements need to be taken into account when establishing whether there is comparability between the situations being compared and what adjustments may be necessary to achieve comparability.”

The economically relevant characteristics are the same characteristics that were considered when accurately delineating the identified transaction. Some broad categories of what these economically relevant characteristics could include are listed in paragraph 1.36 of the OECD guidelines.

**Onus of proof shifted to the taxpayer**

When New Zealand’s transfer pricing rules were introduced in 1995 they placed the onus of proof on the Commissioner. That is, the arm’s length amount of consideration has generally been determined by the taxpayer under section GC 13 of the Income Tax Act 2007.

This position has changed with the repeal of sections GC 13(4) and (5). This means that the general onus of proof in section 149A(2)(b) of the Tax Administration Act 1994 will place the onus of proof for transfer pricing issues onto the taxpayer. New Zealand’s tax system operates on a self-assessment basis, where the taxpayer is expected to keep sufficient records to support its tax position. This change is therefore consistent with the fact that the onus of proof is already on the taxpayer for other tax matters.

It also reflects the practical reality of a transfer pricing analysis. As transfer pricing is driven by specific facts and circumstances and involves comparisons with similar arm’s length transactions, the taxpayer is far more likely to hold the relevant information to support its pricing than Inland Revenue.

At the time of publication, the onus of proof was on the taxpayer for transfer pricing matters in Australia, the United States, Canada, China, Hong Kong, Singapore, the United Kingdom, Ireland, France and Germany. This means most multinationals already prepare transfer pricing documentation that satisfies the onus of proof for other countries.

Putting the onus of the proof onto the taxpayer increases the importance of transfer pricing documentation. A lack of adequate documentation may make it difficult for the company to rebut alternative arm's length conditions proposed by Inland Revenue.
Documentation

The revised chapter V of the OECD’s transfer pricing guidelines recommends a three-tiered approach to transfer pricing documentation:

- a master file providing an overview of the multinational's global business operations, transfer pricing policies and global allocation of income and economic activity;
- a local file providing detailed information regarding material related party transactions; and
- a Country-by-Country report which must be prepared and filed by large multinational groups. New Zealand’s Country-by-Country reporting requirements apply to New Zealand-headquartered multinational groups with EUR €750m of consolidated revenue in the preceding income year. These requirements are further described in the special report on administrative measures (see the section on “Country-by-Country reports” covering the new section 78G of the Tax Administration Act 1994).

New Zealand endorses this approach to transfer pricing documentation. Further guidance on transfer pricing documentation is available in chapter V of the OECD guidelines and the annexes I and II to chapter V which outline the information which should be included in the master file and the local file.

To supplement the OECD guidelines, Inland Revenue publishes some short guidance on certain transfer pricing topics on its website at https://www.ird.govt.nz/international/business/transfer-pricing/.

This supplementary guidance includes a topic on Inland Revenue’s view on best practices for preparing useful and suitably focused transfer pricing documentation at https://www.ird.govt.nz/international/business/transfer-pricing/transfer-pricing-practice/transfer-pricing-practice-documentation.html.

Seven year time bar for transfer pricing issues in some circumstances

Inland Revenue generally has four years from the end of the tax year in which a taxpayer files an income tax return to investigate and amend the tax position taken by the taxpayer in their return. This four year limit is known as the time bar.

The general four year time bar has been extended to seven years for the purposes of the transfer pricing rules in limited circumstances. New section GC 13(6) extends the time bar by allowing the Commissioner to amend an assessment of tax, under the transfer pricing rules, within a seven year period after the tax year in which the relevant tax return was originally filed, if the Commissioner notifies the taxpayer that a tax audit or investigation has commenced within the usual four year time bar.

The notification that a tax audit or investigation has commenced and that the Commissioner is applying GC 13(6) will be provided in writing.

If the Commissioner of Inland Revenue (or an officer of Inland Revenue who has been delegated this authority) has not provided the relevant taxpayer with a written notification within four years of the tax return being filed, the general time bar in section 108 of the Tax Administration Act 1994 will apply.
The notification requirement means the majority of taxpayers will have the same level of certainty as the general four year time bar as they will know after four years that since Inland Revenue has not provided written notification that the time bar for their transfer pricing positions is being extended that these positions are final.

**Example**

In May 2020, Company B files a tax return for their income year from 1 April 2019 to 31 March 2020 which includes some transfer pricing positions.

In May 2024, four years have passed since the tax return was filed. As Inland Revenue has not notified the taxpayer that their transfer pricing positions are being investigated, the taxpayer will have certainty that their transfer pricing positions (and any other tax positions) taken in their May 2020 tax return can be considered final under the general time bar in section 108 of the Tax Administration Act 1994.

In other cases, where Inland Revenue identified a tax risk and notifies the taxpayer within four years of the relevant tax return being filed, Inland Revenue will have seven years from the date the tax return was filed to make a transfer pricing adjustment.

The use of the words “*despite the time bar...*” in section GC 13(6) means that in those cases where 13(6) applies, the seven year time bar overrides the general time bar in section 108 of the Tax Administration Act 1994.

The seven year time bar can be applied for all transfer pricing issues that are subject to sections GC 6 to GC 19, including “cross-border related loans” that are subject to sections GC 15 to 19.

The ability to extend the time bar for transfer pricing issues to seven years under section GC 13(6) applies from income years beginning on or after 1 July 2018. This means that tax positions taken in returns relating to income years that began before 1 July 2018 will continue to be subject to the existing four year time bar.

**Example**

In June 2020, Company C files a tax return for their income year from 1 April 2019 to 31 March 2020.

In 2021, Inland Revenue begins an investigation of Company C’s tax return for their 2019/20 tax year. The investigation involves a series of meetings, site visits, interviews, and requests for information held by Company C and other members of their group as well as procuring expert views on certain issues from independent international specialists.

In January 2024 Inland Revenue provides written notification to Company C that they are being investigated for the transfer pricing positions that they have taken in their June 2020 tax return and that the Commissioner is applying section GC 13(6) to extend the time bar for the transfer pricing issues so adjustments can potentially be made up until June 2027.

In March 2024, Inland Revenue issues a Notice of Proposed Adjustment to Company C regarding their transfer pricing position in their June 2020 tax return. In this case, the extension of the time bar was not actually required, as an assessment was made within four years of the relevant tax return being filed.