International treaty examination of the Agreement between the Government of New Zealand and the Government of the Independent State of Papua New Guinea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Report of the Foreign Affairs, Defence and Trade Committee

Contents

Agreement between the Government of New Zealand and the Government of the Independent State of Papua New Guinea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Recommendation

The Foreign Affairs, Defence and Trade Committee has conducted an international treaty examination of the Agreement between the Government of New Zealand and the Government of the Independent State of Papua New Guinea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, and recommends that the House take note of its report.

The committee supports the double taxation agreement and has no matters to bring to the attention of the House. The national interest analysis for the agreement is appended to this report.

Appendix A

Committee procedure

The international treaty examination of the Agreement between the Government of New Zealand and the Government of the Independent State of Papua New Guinea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income was referred to the committee on 10 December 2012. We met on 31 January 2013 to consider the agreement.

Committee members

John Hayes (Chairperson)
Hon Phil Goff
Dr Kennedy Graham
Hon Tau Henare
Dr Paul Hutchison
Su'a William Sio
Lindsay Tisch

Appendix B

National Interest Analysis

Double Tax Agreement with Papua New Guinea

1 Executive summary

1.1 On 29 October 2012, New Zealand signed the Agreement between the Government of New Zealand and the Government of the Independent State of Papua New Guinea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Papua New Guinea DTA).

1.2 Double tax agreements (DTAs) are bilateral international treaties that are principally designed to encourage growth in economic ties between countries. They do this by reducing tax impediments to cross-border services, trade and investment. The negotiation of, and giving of effect to, DTAs is authorised by section BH 1 of the Income Tax Act 2007. New Zealand has 37 DTAs in force, primarily with New Zealand's major trading and investment partners.

1.3 Although Papua New Guinea is not currently a major trading and investment partner, the key factor that led to negotiations with Papua New Guinea was the identification of significant opportunities for New Zealand tax residents in the large mining and petroleum projects currently being undertaken in Papua New Guinea. In particular, a multi-billion-dollar ExxonMobil-led liquid natural gas project will take over 30 years. The initial (US$15 billion) phase of the project involves construction of gas production, processing and storage facilities, together with over 700 kilometres of pipelines to connect the facilities. As a consequence of this investment, almost every sector of Papua New Guinea's economy is growing.

1.4 New Zealand companies are operating at a disadvantage compared with Australian companies that are competing for those same business opportunities. This is because Australia has had a DTA with Papua New Guinea since 1989. Under that DTA, Australian companies can structure their affairs to minimise or eliminate their tax obligations to the Papua New Guinea Government. Papua New Guinea's income taxes are complex and significant. (Taxes on companies typically aggregate to at least 48%, compared to 28% in New Zealand.) Reducing tax obligations to the Papua New Guinea Government will provide a number of practical advantages to New Zealand businesses in areas such as profit impact, compliance costs, cash flow, the ability to make competitive tenders, and the pass-through of imputation credits to shareholders.

1.5 As in all negotiations, the New Zealand DTA with Papua New Guinea represents a compromise between the starting positions of both countries. However, only one compromise made by New Zealand in the Papua New Guinea DTA is of any potential significance. That compromise relates to New Zealand's agreement to Papua New Guinea's request for a tax sparing mechanism to be included in the treaty. Tax sparing provisions were once a common feature of DTAs between developed and developing countries. The developed country would agree to provide a tax credit for tax deemed to be paid in the developing country, but not actually paid because of a tax exemption intended to attract foreign investment. New Zealand stopped providing tax sparing provisions some years ago, for tax policy reasons. The tax sparing mechanism agreed with Papua New Guinea therefore represents a concession. However, recent changes to New Zealand's international tax rules mean that tax sparing is now a relatively minor issue for New Zealand. Additionally, the mechanism will apply only in circumstances agreed to between the two Governments in an exchange of letters, and it is not expected that the mechanism will ever be invoked. The mechanism will terminate after a ten-year period.

2 Nature and timing of the proposed treaty action

2.1 The Agreement between the Government of New Zealand and the Government of the Independent State of Papua New Guinea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Papua New Guinea DTA) was signed on 29 October 2012.

2.2 The proposed treaty action is to bring the Papua New Guinea DTA into force through an exchange of diplomatic notes that confirm the completion of the respective constitutional and legal requirements for entry into force by each country, pursuant to Article 26 of the Papua New Guinea DTA.

2.3 Before the treaty action is taken, the Papua New Guinea DTA must successfully undergo Parliamentary treaty examination, in accordance with Parliament's Standing Order 394, and must successfully be given the force of law in New Zealand by an Order in Council made pursuant to section BH 1 of the Income Tax Act 2007.

3 Reasons for New Zealand becoming Party to the treaty

General reasons for New Zealand's conclusion of double tax agreements

3.1 New Zealand began entering into double tax agreements (DTAs) in 1947, and currently has a network of 37 DTAs in force, predominantly with New Zealand's main trading and investment partners.

3.2 DTAs are bilateral international treaties that are principally designed to encourage growth in economic ties between countries. DTAs do this by reducing tax impediments to cross-border services, trade and investment. Some impediments to cross-border economic activity can be addressed unilaterally. For example, New Zealand generally relieves double taxation by unilaterally allowing tax residents who derive foreign-sourced income to credit foreign tax paid against their New Zealand tax liability. New Zealand also unilaterally reduces withholding taxes on certain forms of inbound investment. However, unilateral solutions cannot address all of the issues that arise from cross-border activity. Moreover, the country applying unilateral measures must then bear the full cost of the relief. DTAs address these problems by facilitating bilateral solutions. DTAs enable a wider range of issues to be addressed than is possible unilaterally, and also enable the parties to a DTA to share the cost of providing relief.

3.3 DTA networks make an important contribution to the expansion of world trade and to the development of the world economy, which are key objectives of the Organisation for Economic Co-operation and Development (OECD). Internationally, the OECD has therefore assumed a leading role in promoting the use of DTAs. In particular, the OECD has produced a Model Tax Convention, and a comprehensive commentary, for member and non-member countries to use as a basis for concluding DTAs. As a member of the

OECD, New Zealand is subject to an express recommendation issued by the OECD Council in 1997[1] for all member countries:

> 1. to pursue their efforts to conclude bilateral tax conventions … with those member countries, and where appropriate with non-member countries, with which they have not yet entered into such conventions …
>
> 2. when concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention, as interpreted by the Commentaries thereon.

3.4 At a practical level, DTAs are complex technical documents that provide an interface between two, often conflicting, tax systems. The key stakeholders in cross-border economic activity generally favour DTAs for the following reasons:

> *Taxpayers*. A primary concern for any taxpayer contemplating entering into commercial activity in another jurisdiction is that they must comply with the tax and other legal obligations of two separate jurisdictions. This can be perplexing, and obtaining professional advice or tax rulings can be costly and time consuming. Unique issues also arise from cross-border activities, ranging from complex matters such as transfer pricing disputes, to more mundane considerations such as whether taxes paid in the other jurisdiction are creditable against home jurisdiction tax. DTAs help alleviate many of these problems. They establish a framework for the taxation of cross-border activity and establish a mutual agreement procedure for resolving tax disputes.
>
> *Investors*. Investing across an international border always involves risk. Tax laws are often complex and can change suddenly. DTAs assist investors by specifying the maximum rates of tax that can be applied to dividends, interest and royalties. These "headline" rates reduce compliance costs for investors by making it easier to determine the after-tax returns on potential investments. The tax rates are "locked in" by the treaty, which means that investors can make business decisions with confidence. To encourage greater inward investment, governments can unilaterally reduce their taxation of investment income. However, lowering tax rates in a bilateral treaty setting ensures that the rates are also reduced on a reciprocal basis by the treaty partner. This provides benefits to domestic investors.
>
> *Governments*. As double taxation distorts business decisions and generally hinders cross-border economic activity, most jurisdictions unilaterally relieve double taxation of their tax residents. (For example, New Zealand tax legislation provides a general tax credit mechanism.) However, in the absence of a DTA, a jurisdiction bears the full cost of relieving double taxation itself. DTAs allow the cost of relieving double taxation to be shared. They do this by allocating taxing rights between the jurisdictions concerned, on the basis of internationally accepted principles as set out in the OECD Model Tax Convention. Additionally, most countries tax their residents on income earned worldwide. International cooperation between tax authorities is therefore needed to enable tax authorities to verify that income earned in other countries is reported correctly by tax residents. DTAs facilitate this by authorising the exchange of tax-related information (such as

[1] The recommendation follows similar OECD Council recommendations that have been in place since before New Zealand joined the OECD.

tax records, business books and accounts, bank information and ownership information). The exchanged information assists tax authorities to detect and prevent tax evasion and tax avoidance. This is a key benefit of DTAs for governments.

Specific reasons for the double tax agreement with Papua New Guinea

3.5 New Zealand generally only enters into DTAs with countries with which it has an existing or potential significant economic relationship. However, DTAs can also be entered into to exploit a particular opportunity or to address particular taxation problems.

3.6 Until recently, Papua New Guinea would not have been categorised as an existing or potential significant economic partner for New Zealand. In the year to December 2011, New Zealand's merchandise exports to Papua New Guinea amounted to NZ$217 million, and New Zealand imports from Papua New Guinea were NZ$13 million. Investment statistics are not available, but investment in either direction is not thought to be high.

3.7 However, recent international investment in Papua New Guinea has changed that country's economic outlook and has opened significant opportunities for New Zealand business interests.

3.8 Papua New Guinea's economy is now strong (real GDP grew by 8.9% in 2011 and the IMF projects growth of 7.7% in 2012), as a result of confidence generated by large mining and natural gas projects. The most high-profile of these is a multi-billion-dollar ExxonMobil-led liquid natural gas (LNG) project. The initial (US$15 billion) phase of the project involves the construction of gas production, processing and storage facilities, and over 700 kilometres of pipelines to connect the facilities.

3.9 The foreign investment is resulting in increased Government spending and increasing demand across a range of sectors, including food and beverage, technology and communications services. Therefore, in addition to direct engagement in the Papua New Guinea mining and petroleum projects, there are a range of spin-off opportunities in the Papua New Guinea market (which is still relatively unsaturated in many product and service areas). An influx of expatriate workers is, for example, fuelling a property and construction market that is currently returning landlords around 30% per annum on investment.

3.10 Specific opportunities are opening for New Zealand companies in the renewable energy sector, particularly in hydro energy, with additional (but more limited) scope for commercial engagement in geothermal energy. Papua New Guinea's electric power demand is currently increasing at a rate of 10% per annum (in contrast to the previous average annual increase of 2-3% for the past 20 years) and this increased demand is expected to continue for the next six years. This unprecedented increase in demand is putting pressure on generation capacity, the maintenance of existing plant, energy efficiency and new developments. A number of major hydro-electric plants are planned. These developments offer significant opportunities to New Zealand companies, as New Zealand has experience in developing these forms of renewable energy.

3.11 In general, New Zealand is well known and well regarded in Papua New Guinea, and New Zealand's commercial presence is being sought by businesses and the Government.

3.12 New Zealand companies are operating at a disadvantage compared with Australian companies that are competing for those same business opportunities. This is because Australia has had a DTA with Papua New Guinea since 1989. Under that DTA, Australian companies can structure their affairs to minimise or eliminate their tax obligations to the Papua New Guinea Government. Papua New Guinea's income taxes are complex and significant. (Taxes on companies typically aggregate to at least 48%, compared to 28% in New Zealand). Reducing tax obligations to the Papua New Guinea Government provides a number of practical advantages in areas such as profit impact, compliance costs, cash flow, the ability to make competitive tenders, and the pass-through of imputation credits to shareholders.

4 Advantages and disadvantages to New Zealand of the treaty entering into force and not entering into force for New Zealand

4.1 As a bilateral instrument, the Papua New Guinea DTA necessarily involves a trade-off between advantages and disadvantages to New Zealand. On balance, however, entering into the Papua New Guinea DTA is expected to be in New Zealand's overall interests.

Advantages of the treaty entering into force

4.2 The advantages to New Zealand of the Papua New Guinea DTA entering into force can be summarised as follows:

- The DTA can be expected to foster all forms of bilateral economic activity (such as services, trade and investment). This will benefit New Zealand in terms of employment and business opportunities and offshore earnings. As noted below in section 8: Costs, DTAs can generally be expected to give rise to a prima facie revenue cost. However, in the case of Papua New Guinea, these costs are expected to be negligible.
- For New Zealand business interests, the DTA will reduce the cost of importing capital.
- For investors in both jurisdictions, the DTA will reduce compliance costs and provide the certainty of low headline withholding tax rates, locked in by the treaty.
- For investors, businesses and taxpayers from both jurisdictions, the DTA will provide safeguards such as a mutual agreement procedure, which will facilitate the resolution of tax disputes (including disputes in complex areas such as transfer pricing).
- For taxpayers engaged in certain short-term income-earning activities in the other jurisdiction, the DTA will reduce compliance costs and provide cash flow advantages by eliminating the need to pay tax in that jurisdiction and then claim that tax against their tax liability in their home jurisdiction.
- For New Zealand, the DTA will provide an equitable framework for sharing the cost of relieving double taxation between the two jurisdictions.
- In some circumstances, New Zealand will no longer need to provide credits for foreign tax paid.
- For tax authorities, the exchange of information mechanism will assist in the detection and prevention of tax evasion and tax avoidance. The mechanism will also be a general deterrent against evasion and avoidance activity, and will further reduce the opportunities available to residents to escape legitimate New Zealand tax.

4.3 In 2011, the Global Forum on Transparency and Exchange of Information for Tax Purposes concluded a review of New Zealand's legal and administrative frameworks for tax information exchange, and recommended that New Zealand should continue to develop its exchange of information network. The Papua New Guinea DTA will help New Zealand to meet this recommendation.

4.4 A final advantage of the Papua New Guinea DTA is that New Zealand and Papua New Guinea share many treaty policy positions. As a result, New Zealand was able to secure all of its key negotiating positions. The Papua New Guinea DTA therefore represents a good precedent for New Zealand in future negotiations with other countries.

Disadvantages of the treaty entering into force

4.5 As noted above, DTAs offer bilateral solutions to problems that are difficult or impossible to solve unilaterally. However, a potential downside to DTAs is that those solutions are then locked in place by the treaty and are difficult and costly to change. This can create difficulties if treaty provisions need to be changed urgently. Practical experience indicates that in genuine cases, treaty partners are usually amenable to making necessary changes. However, in extreme cases, if the treaty partner were to refuse to cooperate, the treaty could need to be terminated.

4.6 A second general disadvantage of DTAs is that they typically give rise to an up-front revenue cost. This is because DTAs lower withholding tax rates on investment income and allocate taxing rights between the two jurisdictions. The allocating of taxing rights means that New Zealand will lose the ability to tax some income streams that it previously could tax (this applies on a reciprocal basis). However, as noted below in section 8: Costs, in the case of Papua New Guinea, the prima facie revenue costs are expected to be negligible.

4.7 A third general disadvantage of entering into DTAs is that costs will need to be incurred in administering the exchange of information provisions of the DTA. If a treaty partner makes requests for information under a New Zealand DTA, New Zealand will incur costs in complying with those requests. However, New Zealand already has exchange of information arrangements with 55 other jurisdictions (including 37 DTAs and 18 Tax Information Exchange Agreements) and has systems in place for administering those arrangements. The costs of providing information to Papua New Guinea under the Papua New Guinea DTA will therefore be marginal.

4.8 As noted above, New Zealand and Papua New Guinea share many treaty positions, and New Zealand was therefore able to secure all of its key negotiating positions. However, as is usual in negotiations, both sides were required to make some compromises from their starting positions. Only one compromise made by New Zealand in the Papua New Guinea DTA is of any potential significance. That compromise relates to New Zealand's agreement to Papua New Guinea's request for a tax sparing mechanism to be included in the treaty. Tax sparing provisions were once a common feature of DTAs between developed and developing countries. The developed country would agree to provide a tax credit for tax deemed to be paid in the developing country, but not actually paid because of a tax exemption intended to attract foreign investment. New Zealand stopped providing tax sparing provisions some years ago, for tax policy reasons. The tax sparing mechanism agreed with Papua New Guinea therefore represents a concession. However, recent changes to New Zealand's international tax rules mean that tax sparing is now a relatively minor issue for New Zealand. Additionally, the tax sparing mechanism will apply only in circumstances agreed to between the two Governments in an exchange of letters, and it is not expected that the mechanism will ever be invoked. The mechanism will automatically terminate after a ten-year period.

Advantages of the treaty not entering into force

4.9 It is an option not to have a DTA with Papua New Guinea. In that case, the disadvantages identified above will not arise.

Disadvantages of the treaty not entering into force

4.10 If the Papua New Guinea DTA does not enter into force, New Zealand business interests will continue to operate at a competitive disadvantage with Australian firms that do have the protection of a DTA. It is likely that the Government would be strongly lobbied by those New Zealand business interests.

5 Legal obligations which would be imposed on New Zealand by the treaty action, the position in respect of reservations to the treaty, and an outline of any dispute settlement mechanisms

Summary of key legal obligations

5.1 DTAs do not impose requirements on taxpayers. The Papua New Guinea DTA will not (and cannot) require the imposition of a tax that is not already imposed under domestic law. The obligations that DTAs impose are on the respective New Zealand and Papua New Guinea Governments.

5.2 When income is derived from one jurisdiction (the source jurisdiction) by a tax resident of the other jurisdiction (the residence jurisdiction), both countries typically impose tax on that income. DTAs primarily relieve such double taxation by allocating taxing rights. The key allocation of taxing rights in the Papua New Guinea DTA is as follows:

- Business profits of an enterprise will be taxable only in the jurisdiction in which the enterprise is resident, unless profits are derived through a permanent establishment in the source jurisdiction. In that case, the profits may also be taxed in the source jurisdiction. (Article 7 refers.) The term “permanent establishment” is generally defined in the Papua New Guinea DTA as meaning a fixed place of business through which the business of an enterprise is wholly or partly carried on. However, this general rule is supplemented by a number of clarifications and deeming rules which follow New Zealand’s preferred formula, and which will ensure that New Zealand can continue to impose tax on significant business activities such as natural resource exploration or exploitation. (Article 5 refers.)
- Investment income (dividends, interest and royalties) may generally be taxed in both jurisdictions. However, the amount of withholding tax that can be imposed by the source jurisdiction is limited to 15% for dividends (Article 10 refers) and 10% for interest and royalties (Articles 11 and 12 refer). The limitation does not apply if the dividends, interest or royalties are derived in connection with a permanent establishment in the source jurisdiction. In addition, interest will be exempt in the source jurisdiction if derived by the Government of the other State.

- Income from independent personal services will be taxable only in the jurisdiction in which the individual performing the services income is resident, unless (i) the individual has a fixed base in the source jurisdiction, or (ii) the income derived by the individual for performing the services exceeds US$10,000 in any twelve-month period, or (iii) the individual is present in the source jurisdiction for the purpose of performing the services for more than six months in any twelve month period. In such case, the services income may also be taxed in the source jurisdiction. (Article 14 refers.)
- Income from dependent personal services will be taxable only in the jurisdiction in which the employee is resident unless the employee is present in the source jurisdiction for more than six months in a twelve-month period or the employer is a resident of the source jurisdiction (or is non-resident but the employee's remuneration is borne by a permanent establishment in the source jurisdiction). In that case, the employment income may also be taxed in the source jurisdiction. (Article 15 refers.)
- Pensions will be taxable only in the jurisdiction in which the recipient is resident. (Article 18 refers.)

5.3 A number of exceptions to the above rules also apply. These include:

- Income from real property (referred to as "immovable property" in the Papua New Guinea DTA) will always be taxable in the jurisdiction where the property is situated. (Articles 6 and 13 refer.)
- Profits of an enterprise from the operation of ships or aircraft in international traffic will be taxable only in the jurisdiction in which the enterprise is resident. However, profits from domestic carriage by ship or aircraft will always be taxable in the source jurisdiction. (Articles 8 and 13 refer.)
- Directors' fees will always be taxable in the jurisdiction in which the company paying the fees is resident. (Article 16 refers.)
- Income from the activities of entertainers and sportspersons will always be taxable in the source jurisdiction. (Article 17 refers.)
- Salaries and wages for services to a Government of one jurisdiction will generally be exempt from tax in the other jurisdiction. (Article 19 refers.)

5.4 Where the allocation of taxing rights permits both jurisdictions to tax an item of income, the Papua New Guinea DTA will require New Zealand to relieve double taxation of its residents by allowing a credit for the tax paid in Papua New Guinea. (Article 22 refers.) This is consistent with the unilateral relief mechanism that already applies under New Zealand domestic law. The obligation also applies reciprocally, so Papua New Guinea must allow its residents a credit for New Zealand tax paid.

5.5 In addition to the above obligations, New Zealand will be required to comply with various administrative requirements imposed by the Papua New Guinea DTA. These are as follows:

- Mutual agreement procedure. New Zealand must comply with the procedures for settling disputes set out in the mutual agreement procedure article of the Papua New Guinea DTA. (Article 23 refers.) This is discussed below, in the section *Dispute resolution.*
- Exchange of information. As discussed, the Papua New Guinea DTA includes an Article that provides for the exchange of tax-related information between tax authorities, for the purpose of detecting and preventing tax evasion and tax avoidance. New Zealand will be required to respond to requests for information from Papua New Guinea. If Inland Revenue receives a valid request, and if it does not already hold the requested information, it must use its information-gathering powers to obtain the information. Inland Revenue can similarly request information from Papua New Guinea. (Article 24 refers.)

Dispute resolution

5.6 The Papua New Guinea DTA establishes a "mutual agreement procedure" for resolving disputes. Under this procedure, a taxpayer who considers that they have been taxed incorrectly under the treaty, including in transfer pricing cases, can approach their local tax authority under Article 23 to invoke a mutual agreement procedure. If the tax authority considers the case to be justified, and is unable to resolve the case through its own actions, it must approach the tax authority of the other jurisdiction to seek a bilateral resolution. This bipartisan approach is particularly appropriate in the tax treaty context because a single issue will generally affect a person's tax position in both jurisdictions. The mutual agreement procedure is not a true disputes resolution mechanism, as the two sides are only obliged to "endeavour" to reach resolution. However, the taxpayer remains free to pursue a case through the courts (including if they do not agree with the decision reached under the mutual agreement procedure).

5.7 The mutual agreement procedure also authorises the tax authorities of the two jurisdictions to collectively resolve any difficulties or doubts about the correct interpretation or application of the Papua New Guinea DTA.

Reservations

5.8 The Papua New Guinea DTA does not allow parties to make a reservation upon ratification.

6 Measures which the Government could or should adopt to implement the treaty action, including specific reference to implementing legislation

6.1 Subject to the successful completion of the Parliamentary treaty examination process, the Papua New Guinea DTA will be incorporated into domestic legislation by Order in Council pursuant to section BH 1 of the Income Tax Act 2007. Section BH 1 authorises the giving of overriding effect to DTAs by Order in Council. However, the override relates only to tax matters, and applies only in respect of the Inland Revenue Acts, the Official Information Act 1982 and the Privacy Act 1993.

6.2 The override of the Inland Revenue Acts is necessary to give effect to the core provisions of the Papua New Guinea DTA, which may provide relief from tax that would otherwise be imposed under domestic law. The override of the Official Information Act is necessary to ensure that confidential communications with the other jurisdiction do not have to be disclosed. The override of the Privacy Act is necessary to ensure that information regarding natural persons can be exchanged according to the terms of the treaty.

6.3 Article 26 of the Papua New Guinea DTA provides for the agreement to be brought into force through an exchange of diplomatic notes between the Contracting States. The Papua New Guinea DTA will enter into force on the date of the last of these notes. New Zealand will be able to notify Papua New Guinea that all procedures required by domestic law have been completed once the Order in Council has entered into force, which will be 28 days after its publication in the New Zealand Gazette.

6.4 Thereafter, the provisions of the Papua New Guinea DTA will have effect from various dates, according to the terms of the DTA. In New Zealand, the provisions relating to withholding taxes will generally take effect 2 months after the date of entry into force. The provisions relating to other taxes will have effect for income years beginning on or after 1 April in the calendar year following the year in which the DTA enters into force.

6.5 As an alternative to the above Order in Council mechanism, the Papua New Guinea DTA could be given legislative effect by means of the enactment of a dedicated statute. However, this option would unnecessarily increase the amount of primary tax legislation, and is therefore not preferred.

7 Economic, social, cultural, and environmental costs and effects of the treaty action

7.1 No social, cultural or environmental effects are anticipated.

7.2 As noted elsewhere in this National Interest Analysis, the overall economic effects of the Papua New Guinea DTA are expected to be favourable to New Zealand. This is because the Papua New Guinea DTA can be expected to encourage growth in economic activity, and to assist Inland Revenue to detect and prevent tax evasion and tax avoidance. It is not possible to quantify the economic benefits but, overall, the benefits are expected to outweigh the costs.

8 The costs to New Zealand of compliance with the treaty

8.1 DTAs constrain New Zealand from taxing certain income and limit the rate at which tax on dividends, royalties and interest can be imposed, and therefore typically can be expected to result in some prima facie reduction of New Zealand tax.

8.2 This potential upfront revenue cost is typically offset by other factors. For example, there will be an offsetting effect to the New Zealand tax base from the reduction of tax in the other country, and the reduced need for New Zealand to allow foreign tax credits. There will also be some revenue gains from the expected reduction in tax evasion and tax avoidance resulting from the DTA exchange of information provisions.

8.3 Data limitations prevent officials from accurately estimating the actual revenue cost of the Papua New Guinea DTA. However, due to the limited existing trade and investment flows between Papua New Guinea and New Zealand, any reduction of New Zealand tax is expected to be negligible.

8.4 The tax sparing provisions of the DTA are not expected to give rise to specific costs. The provisions will apply only in circumstances agreed to between the two Governments in an exchange of letters. Furthermore, the provisions will terminate after a ten-year period.

8.5 In general, as discussed above, DTAs are also expected to give rise to favourable economic benefits, such as increased cross-border services, trade and investment. Again, officials cannot quantify the economic benefits of the Papua New Guinea DTA but, overall, the benefits are expected to outweigh the costs.

8.6 The exchange of information provisions of the Papua New Guinea DTA will result in some administrative costs for Inland Revenue, arising from the need to respond to requests for information from Papua New Guinea. Based on previous experience, the numbers of requests are not expected to be significant. If requests are received, Inland Revenue already has efficient systems in place for administering the exchange of information provisions of New Zealand's other 37 DTAs and 18 Tax Information Exchange Agreements, and the additional costs will be marginal.

8.7 Compliance costs for New Zealand businesses are expected to be reduced under the Papua New Guinea DTA. This is because New Zealand businesses will have clear guidance about when they will be liable for tax on activities in Papua New Guinea, in line with internationally recognised norms.

9 Completed or proposed consultation with the community and parties interested in the treaty action

9.1 The Treasury, and the Ministry of Foreign Affairs and Trade, were consulted about the terms of the Papua New Guinea DTA and the content of this extended National Interest Analysis, and agree with its analysis and conclusions.

9.2 New Zealand Trade and Enterprise was consulted in the lead-up to the negotiations, and supported the proposal to conclude a DTA with Papua New Guinea.

10 Subsequent protocols and/or amendments to the treaty and their likely effects

10.1 The Papua New Guinea DTA does not expressly set out the process for amendment of the agreement, and no specific amendments are currently anticipated. However, New Zealand will consider any future amendments on a case-by-case basis. Future amendments will be subject to New Zealand's normal domestic approvals and procedures for DTAs.

11 Withdrawal or denunciation provision in the treaty

11.1 Under Article 27 of the Papua New Guinea DTA, after the expiry of five years from the date of entry into force, either party may terminate the agreement by giving notice of termination through diplomatic channels. Article 27 generally follows the approach used in New Zealand's other DTAs.

12 Agency Disclosure Statement

12.1 Inland Revenue has prepared this extended national interest analysis (NIA). Inland Revenue has analysed the issue of implementing the new DTA between Papua New Guinea and New Zealand, and the legislative and regulatory proposals arising from that implementation. As part of that process, Inland Revenue considered the option of not entering into the treaty. Inland Revenue is of the view that there are no significant constraints, caveats or uncertainties concerning the regulatory analysis. The policy aligns with the Government Statement on Regulation.

12.2 The allocation of taxing rights under the Papua New Guinea DTA is consistent with the New Zealand negotiating model, which in turn is based on the OECD's Model Tax Convention. The revenue cost to New Zealand as a result of the allocation of taxing rights under the DTA is expected to be negligible.

12.3 The tax sparing mechanism agreed with Papua New Guinea represents a potential risk. The mechanism will apply only in circumstances agreed to between the two Governments in an exchange of letters. The mechanism therefore has a potential cost to New Zealand. The tax sparing mechanism could be seen as potentially creating a precedent that may lead to other developed countries seeking a similar provision. However, that precedent already exists. (Eight of New Zealand's existing DTAs contain tax sparing provisions.) Moreover, the mechanism will terminate after a ten-year period.

12.4 An Order in Council will be required to give the new DTA effect in New Zealand law. The Order in Council will override the Inland Revenue Acts, the Official Information Act 1982 and the Privacy Act 1993; this is authorised by section BH 1 of the Income Tax Act 2007 and is necessary to give effect to the terms of the new DTA.

12.5 The Ministry of Foreign Affairs and Trade, and the Treasury, have been consulted about the terms of the Papua New Guinea DTA and the content of this extended NIA, and no concerns were raised. The proposal also has the support of Trade and Enterprise New Zealand.

12.6 Inland Revenue's view is that the policy options considered will not impose additional costs on business interests; nor impair private property rights, market competition, or the incentives for business to innovate and invest; nor override fundamental common law principles.

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