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Deputy Commissioner, Policy and Strategy
Inland Revenue
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Dear Deputy Commissioner

BEPS – Strengthening our interest limitation rules

Thank you for the opportunity to comment on the Government's discussion document: BEPS – Strengthening our interest limitation rules (**Discussion Document**).

We would like to make the following submissions:

- the interest rate cap should not be introduced because it conflicts with the arm's length principle that is accepted globally for pricing related-party debt and has potential double tax implications (Chapter 3 of the Discussion Document); and
- the ability for taxpayers to use net current asset value for thin capitalisation calculations should be retained (Chapter 5 of the Discussion Document); and
- Grandparenting provisions should take into account existing Advance Pricing Agreements ('APA') and loan terms; and
- Gross assets should not be adjusted for non-debt liabilities.

We set out some background information about us, and our more detailed submissions, below.

1. About us

Methanex New Zealand Limited (MNZ) is ultimately owned by Methanex Corporation, a Canadian corporation which is listed on the Toronto Stock Exchange and the NASDAQ Global Market. Methanex Corporation, together with its global subsidiaries (the Group), produces and sells methanol globally. MNZ owns two methanol facilities in NZ, and produces methanol primarily for export to markets in Japan, Korea and China. It's estimated methanol production adds $650 million to New Zealand's GDP each year, and sustains 1200 jobs directly and indirectly.[1]

Methanex Asia Pacific Limited, the immediate parent of MNZ, has advanced substantial intra-group funding to MNZ. MNZ has an APA with Inland Revenue in respect of this funding dated 23 December 2013.

[1] Economic Impact Analysis undertaken on behalf of Methanex by Business and Economic Research Limited ("BERL"), March 2013

Methanex Corporation subsidiaries operate in multiple jurisdictions globally and therefore it has considerable experience in operating within many legal and tax systems. In this context, Methanex Corporation has admired the stability of the NZ legal and tax systems and in particular the robustness of the tax policy/change process. We support the Government's desire to protect the tax base and ensure multinationals "pay a fair amount of tax". It has been on this basis that MNZ has for many years adopted an open and transparent dialogue with the Inland Revenue Department in relation to its tax profile and any proposed transactions/events. It is with this background that we respectfully express our surprise and concern about the proposed speed and novel approach being proposed in parts of the Discussion Document. The NZ economy is heavily reliant on inward investment with the associated benefits, economic and otherwise. There is some risk that the current proposed approach undermines the confidence of foreign investors in NZ.

2. An interest rate cap should not be introduced – debt should be priced on an arm's length basis

Intra-Group funding is priced on an arm's length basis in most of the other jurisdictions in which we operate. The arm's length principle may be applied slightly differently in different jurisdictions, with the result that interest income may not match interest deductions under domestic laws in all cases. However, double tax agreements override domestic laws to require such interest to be dealt with consistently between the two relevant jurisdictions (where the arm's-length approach is being followed) through corresponding adjustments and access to the mutual agreement procedure.

Our primary concern with the proposed interest rate cap is that it would be a fundamental shift away from pricing debt on this basis, giving rise to a risk of double taxation where interest income and interest deductions do not match, that cannot be mitigated through a double tax agreement. For this reason, the interest rate cap should not be introduced.

Pricing intra-group debt using arm's length principles (as strengthened by the Government's proposals in relation to transfer pricing) is consistent with the OECD's work under its BEPS project. Under Actions 8-10, the OECD concluded that the arm's length principle (based on economic reality rather than legal form) was the most effective and efficient way to price intra-group transactions. We understand that the OECD will be carrying out further work this year in relation to the transfer pricing aspects of financial transactions between related parties.

Pricing debt on this basis is also consistent with the OECD's work on BEPS involving interest deductions (Action 4). The OECD recognised that thin capitalisation rules which limit the level of debt (as New Zealand's rules do) do not address BEPS concerns where an excessive rate of interest is applied to a loan, and suggested that a further mechanism, such as an arm's length test, would be needed to address this particular concern.[2]

Lastly, imposing the Methanex Corporation credit rating on the NZ subsidiary is a blunt approach that ignores the significant difference in risk profiles between a global parent and a manufacturing subsidiary. Throughout our APA process in 2013 undertaken with Inland Revenue staff, it was clearly understood that the parent credit rating could never be achieved by the stand-alone subsidiary. It is a significant shift to now propose that the parent credit rating determines the interest rate cap – we are not aware of this approach being applied in any of the other jurisdictions we operate in.

[2] OECD/G20 Base Erosion and Profit Shifting Project: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments Action 4 – 2016 Update, paragraphs 58 & 59. In paragraphs 12-15 of that paper, the OECD commented that an arm's length amount of debt (and similar tests) on its own would not address all of the OECD aims of Action 4, but that it might still have a role to play alongside other tax policy goals. These comments do not indicate that arm's length principles should not be used to price debt.

3. Ability to use market values should be retained

The Discussion Document, at paragraph 5.25 states "…we consider that the valuation method chosen for financial reporting purposes will be the one that most fairly represents the value of a company's assets". This is not correct. Your Tax Information Bulletin: Volume Seven, No.11, Page 19 (March 1996) correctly said (when the thin capitalisation rules were first introduced) – "…it is recognised that the valuations for financial reporting purposes are likely to have been adopted for other than tax reasons". Consequently it was concluded that a taxpayer should be able to use net current value/market value if that taxpayer could have adopted it for assets under GAAP (now IFRS) but has chosen not to.

MNZ values its assets at historical cost for NZ financial reporting purposes. We are permitted to use market value under IFRS (IAS 16 and IAS 8). However, we choose not to do so, because there is no benefit to the Group or its shareholders in incurring the additional expense of preparing NZ financial statements on this basis. The group's published financial statements are prepared by Methanex Corporation on a consolidated basis, and these are the financial statements that are generally used to report to shareholders and for other purposes. MNZ's individual entity accounts effectively serve only to meet NZ Companies Office obligations.

The ability to use net current value/market value where permitted by IFRS should be retained. We understand that the Government's concern is that valuations used for thin capitalisation purposes but not for financial reporting purposes may not be subject to a sufficient level of independent scrutiny. We don't believe this should be a concern for MNZ because MNZ use asset valuations undertaken by a qualified valuer for thin capitalisation purposes.

If the ability to use net current value is not retained, taxpayers will, for tax reasons, adopt net current value for financial reporting purposes despite it making no sense for commercial reasons. This change of accounting policy in financial statements under IAS 8 can be made (ie. it is elective) if the result is more reliable or relevant. This will particularly be the case when there is a significant difference between the historical cost and market value of assets.

We strongly submit that the ability to use net current values/market value for thin capitalisation purposes needs to be retained.

Concerns could be addressed by requiring valuations being adopted for thin capitalisation purposes to be supported by a valuation from a registered valuer, or a similarly qualified independent person. As noted above, this is our current approach (which has been fully disclosed to Inland Revenue).

4. Grandparenting

The Discussion Document states that the proposals will apply from the beginning of the first income year after enactment. Assuming that the proposals proceed, we consider that this application date is too soon in the context of the significance of the changes being implemented. It does not allow sufficient time for us to model the impact and plan a potential restructure or refinancing in response. We submit that the application date for any new policy should be at least one income year post enactment.

There should also be grandparenting for existing APAs until the end of the currently agreed term of the APA or the term of the relevant loan, whichever is the longer. Any proposal to not respect existing APAs undermines the credibility of the tax system. We went to significant time (our global treasurer travelled to NZ to engage in the APA process) and cost to agree the APA and strongly believe APAs should remain in place. We also consider that existing financing arrangements covered by an APA should be grandparented to their original/current term where that exceeds the current APA term. This provides certainty for the multinational and allows time to refinance.

5. Treatment of non-debt liabilities

We do not consider that requiring gross assets to be adjusted for non-debt liabilities is consistent with the core objectives of a thin capitalisation regime. It arbitrarily distorts the thin capitalisation percentage depending on the timing and the make-up/nature of liabilities recorded for accounting purposes under IFRS.

We also consider that if there is a change to net assets (ie. deducting non-debt liabilities most of which will be disclosed at market value), that to ensure consistency, asset values should also be able to be expressed at market value (net current value). Finally, liabilities not funding a taxpayer's balance sheet should be excluded eg. deferred tax liabilities (as per the Australian rules).

Conclusion

We trust you find our submissions useful. Please contact me if you would like to discuss any aspect further.

Yours sincerely

Kevin Maloney
Managing Director
Methanex NZ Limited