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BEPS – Transfer pricing and PE avoidance
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
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21 April 2017

By email: policy.webmaster@ird.govt.nz

Dear Cath

BEPS – Transfer pricing and permanent establishment avoidance

We support the consultative approach adopted by the Government in its adoption of measures associated with the G20/OECD-led Base Erosion and Profit Shifting ("BEPS") project.

BEPS – Transfer pricing and permanent establishment avoidance forms part of an interconnected package, alongside *BEPS – Strengthening our interest limitation rules* and *New Zealand's implementation of the multilateral convention to implement tax treaty related measures to prevent BEPS.* The package is a powerful combination, which will put New Zealand at the forefront of worldwide approaches to BEPS implementation.

This submission should therefore be read alongside our submissions on the other elements of the package.

Permanent establishment avoidance and amendments to source rules

We agree that economic activities which should result in a permanent establishment ("PE") in New Zealand should be subject to tax here. Nevertheless, the discussion document does not provide a compelling case for the adoption of measures in domestic legislation regarding PEs and source-based taxation.

In general, we support New Zealand's implementation of the multilateral convention to implement tax treaty related measures to prevent BEPS.[1] As elaborated in Appendix A, the multilateral convention is the best opportunity for a coordinated international approach, with significant risks inherent in New Zealand departing from international norms through the introduction of standalone rules.

New Zealand's position can be distinguished from that of Australia and the United Kingdom. Those countries' early action has had the effect that their equivalent rules will be in place for a period of several years before the multilateral convention applies: the impact of their rules includes being a transitional bridge for an interim period. New Zealand's later application means this argument has little force here.

[1] See our submission regarding *New Zealand's implementation of the multilateral convention to implement tax treaty related measures to prevent BEPS.*

Should New Zealand seek to introduce the PE and source rules proposed, it will be important that legislation be drafted with great clarity as to scope and application. Our experience in the United Kingdom and Australia shows that poorly drafted rules lead to disputes, with uncertain outcomes for taxpayers and deteriorating relationships between multinationals and tax administrations.
Further, if the rules are adopted, there should be a substantial lead time before they take effect. Multinational groups often structure their supply chain consistently across all operating territories. Restructuring will be complex and will require time.

As set out in Appendix B, we have a particular concern that amendments to the source rule overreach: they could tax foreign sourced income of non-residents in contravention of New Zealand's international tax framework.

Transfer pricing

We support better alignment with Australian transfer pricing rules given the high level of trans-Tasman investment and degree of business integration - but only to the extent those rules remain consistent with the principles set down by the OECD and do not seek to tax a greater than arm's length proportion of profit.

That means we support aligning transfer pricing rules with economic substance and giving Inland Revenue the power to reconstruct transactions. Reconstruction should, however, only be an option in exceptional circumstances and this, or similar, wording should be included in legislation. The Commissioner must not treat unsuccessful commercial decisions as irrational and our support is conditional upon appropriate safeguards to protect taxpayers.

It is important for any changes to be prospective, both in law and practice. It is not appropriate for Inland Revenue to apply the 2016 revisions to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines") to transactions that occurred before the publication of the revised Guidelines.

If the taxpayer is to bear the burden of proof in relation to transfer pricing, we consider that Inland Revenue should be more prescriptive around what is required by way of evidence. Documentation requirements should be set out in some formal way (rather than through webpages on the transfer pricing section of Inland Revenue's website).

We see little justification for an extension to time bar for transfer pricing enquiries. New Zealand's current four year time bar is by no means out of step with other countries, with any extension running contrary to the real time approach adopted as a part of Business Transformation.

With the expansion of Inland Revenue's powers under the proposed transfer pricing rules, it will become more important for specific guidance to be available to taxpayers and advisors. Guidance would be welcome regarding documentation requirements, comparable and benchmarking, and the circumstances in which particular transfer pricing methods are favoured by Inland Revenue. This should be provided by way of detailed rulings or interpretation statements rather than informal website changes.

We expand these points in Appendix C.

Administrative measures

Collection of information in transfer pricing audits is time consuming and draws heavily on both Inland Revenue and taxpayer resources. We are not convinced that granting the Commissioner extensive additional powers will resolve the difficulties. Instead many of the proposed administrative measures could better be resolved by additional resourcing of Inland Revenue's transfer pricing and investigations teams.

Our comments on the specific measures proposed are provided in Appendix D.

Future engagement

The consultation period following release of the discussion documents has been short. To that end, our submission is intended to flag issues which we consider require further analysis, and, where appropriate make recommendations on the approach. We look forward to continuing to engage in discussion on the proposals throughout the coming policy-making and legislative stages.

We understand that these submissions may be the subject of a request under the Official Information Act 1982, and consent to the submissions being made publicly available.

We would appreciate the opportunity to discuss our submissions in person. Please contact David Snell (david.snell@nz.ey.com, +64 21 845 361) in this regard.

Yours sincerely

Aaron Quintal
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Appendix A – Permanent Establishment Avoidance

Multilateral instrument should be implemented before considering further permanent establishment reforms

We agree that economic activities which should result in a permanent establishment in New Zealand should be subject to tax here and support a rule which does not widen the accepted international definition of a PE in substance (paragraph 3.2).

New Zealand's implementation of the *Multilateral convention to implement tax treaty related measures to prevent BEPS* has the potential to address most, if not all, of these concerns. On this basis, we suggest efforts should focus on its implementation and resultant impact before introducing potentially wide ranging domestic PE and source reforms, with uncertain application.

Should that approach not be adopted, it will be of critical importance that legislation be drafted with great clarity as to scope and application. We are concerned that where the wording adopted is in any way ambiguous or uncertain this would lead to significant taxpayer uncertainty around the validity of global operating models and a significant increase in the number of disputes between taxpayers, Inland Revenue and other tax authorities.

We have a further concern that the proposals will not be consistent with our existing double tax agreement ("DTA") commitments and will therefore fail to work in practice.

Our concerns are driven by the experience to date with comparable rules in Australia and the United Kingdom. Our understanding is that uncertainty in the wording of the corresponding legislation in these territories has led to:

- A significant rise in the number of cross-border tax disputes.
- Concern among taxpayers that the Australian Tax Office and Her Majesty's Revenue and Customs are "cherry picking' arguments, leading to greater incidence of the rule being invoked than stated at the time of introduction. This is in contrast to a principled approach taking into account the underlying commercial substance of a given arrangement.
- Apparent administrative difficulties within the Australian Tax Office, evidenced by delays in providing guidance around its diverted profits tax.
- An increase in compliance costs, with costly restructuring imposed on global supply chains for little benefit to revenue authorities or multinationals.
- The threat of the legislation being used to compel taxpayers into costly and impractical changes to their operating models, notwithstanding that there may be strong technical support for the tax position.
- Consequent damage to the relationship and mutual trust between taxpayers and tax authorities.

Application of the rule (paragraphs 3.20 to 3.26)

If the PE avoidance rule is adopted, there should be a transitional rule to enable taxpayers to structure out of arrangements that would give rise to a deemed PE.

Inland Revenue should provide guidance on the meaning of various new concepts which form part of the rule – notably “commercially dependent”, “in connection with”, “low tax jurisdiction”, “high paid employee” and “specialised services”.

Need for transitional rule (paragraph 3.20)

Paragraph 3.20 provides that the proposed rule will apply to income years beginning on or after the date of enactment. We submit there should be a transitional rule to enable taxpayers to structure out of arrangements that would give rise to a deemed PE. The rule should apply only with effect to income years beginning three years on or after the date of enactment, as reorganising global supply chains can be a complex business, with New Zealand unlikely to be central to many multinational enterprises’ structures.

There will be taxpayers subject to these rules with existing investment structures that have previously been reviewed by Inland Revenue, in some cases perhaps having obtained rulings, tax audit sign-offs or Advance Pricing Agreements (“APAs”). Formerly compliant taxpayers should be given time to comply with any new rules.

In particular, it is common for multinational groups to structure their supply chain or operating model on a consistent basis across all operating territories. Restructuring in accordance with the proposed New Zealand rule will often not be as simple as amending New Zealand aspects and will often require fundamental change to global operations. This, by definition, has flow on consequences (commercial and tax) in a large number of territories and it follows that this is not something that can (or should) be undertaken quickly. It is considered inappropriate to impose such a short time frame for realignment (with the threat of 100% penalty if that timing is not met) for many or most taxpayers.

A related point is considered below in the “consequences of application” section of this submission regarding the imposition of a 100% penalty for currently compliant structures in the absence of grandparenting.

We have particular concerns that Inland Revenue may seek to assess companies planning to restructure ahead of these changes. There is a possible case for an Operational Statement regarding implementation. Otherwise companies will be unwilling to change arrangements as this could be seen as an admission of tax avoidance.

New concepts will require explanation (paragraphs 3.21 and 3.24)

Any legislation needs to be sufficiently clear in what it is intended to do to ensure taxpayers are capable of complying with it at a reasonable outlay of time and cost. In particular the legislation needs to clarify:

- The rule will apply where there is a related entity that is either “associated” or “commercially dependant (sic)” (paragraph 3.21). The discussion document does not provide in-depth analysis as to the meaning of “commercially dependent” - although this appears to be quite broad. There will be many situations where an entity is arguably commercially dependent on a major customer, even though the agent is independent. For example, would an independent agent who received over 50% of revenue from a single foreign entity be “commercially dependent” on that entity? The “commercially dependent” terminology could also pick up relationships such as independent distributors whose business is limited to one brand, which we assume is not the intent of the rules. A car dealership would be an example of a commercially dependent, but independent, agent, albeit one likely already to have a taxable presence in New Zealand. Alternatively, is "commercially dependent" intended to be consistent with the dependent agent clause in New Zealand's DTAs? We note that New Zealand businesses, given its relatively small market size, could be particularly susceptible to triggering "commercial dependence" where this is sufficiently widely drafted to catch arm's length dealings with major or sole offshore customers. Given New Zealand business' unique bargaining position (or lack thereof) as a function of relative size, particular care should be taken to ensure this concept is not drafted so as to apply far more broadly than intended.

- The rule is to apply where a related entity carries out an activity in New Zealand "in connection" with a particular sale (paragraph 3.21). The discussion document does not address what constitutes "in connection". This is a broad term and may need more clarification. At present, it is unclear whether there must be a direct causal connection that actually brings about the sale or whether an indirect connection (e.g., any activity which facilitates the sale) is sufficient. We note Australia and the United Kingdom have taken different approaches to this issue, with Australia requiring a direct connection. We would suggest that the Australian "direct" connection approach should be favoured to ensure nebulous connections to sales activity cannot be caught by virtue or "mere" or ancillary connection.

- Indicators of a PE include the involvement of a "low tax jurisdiction" (paragraph 3.24). It will be important to define this term. Does "low tax jurisdiction" mean lower than 28%, 20%, 15% or other? Many corporate tax rates have fallen in recent years, with the United Kingdom currently at 20% but scheduled to fall to 17% in 2020 one example. Is the tax base, as well as rate, a relevant factor? Proposals to introduce a border tax adjustment, combined with a reduced rate, could potentially bring the United States into any definition. There could also be issues regarding jurisdictions which have a low company tax rate but instead tax other bases (such as a resource rent tax or royalties), with state-level taxes, or with tax rate changes over time.

- PE indicators also include the existence of "a number of well paid employees". Clarity regarding what is meant by a "well paid employee" would be welcome. It can also be argued that a combination of well paid employees and low profits is a transfer pricing, rather than PE, issue.

- Finally, the term "specialised services" is unclear. What are "specialised services" and why is that indicative of a PE? Turning again to the concept of ancillary services, these are often highly specialised and it is suggested that often a high degree of specialisation would support significant separation from sales activity.

Arrangements involving third party channel providers (paragraphs 3.27 to 3.31)

More guidance is needed in respect of what would constitute "sales promotion and services"

The concept of "sales promotion and services" is crucial to the application of the rule to arrangements involving third party channel providers and should therefore by explained. For example, if a related party organises a tradeshow for a number of different suppliers, would this constitute "sales promotion and services"?

Consequences of application (paragraphs 3.32 to 3.39)

More guidance is needed on Inland Revenue's approach to profit attribution. Applying a 100% abusive tax position appears harsh given the lack of grandparenting for existing structures which fully comply with current law.

Paragraph 3.35 notes that profits attributable to the deemed PE will be determined by normal profit attribution principles. We have no issue with this statement, but Inland Revenue guidance on normal profit attribution principles is limited. If Inland Revenue were to apply a method different to that of a trading partner, then double taxation and further pressure on the mutual agreement procedure ("MAP") are likely outcomes.

That concern is reinforced by the statement in paragraph 3.36 that application of normal profit attribution principles will "result in a fairly significant amount of the sales income being attributable to the deemed PE" in most cases. It is not clear to us that this should be the outcome: if, as will often be the case, little value is added in New Zealand, then the attributed profit will be small. Expenses will also be attributed to New Zealand, rather than attribution being based on gross sales income alone.

As an obvious example, it would be expected that an unrelated New Zealand supplier, albeit one with a degree of "commercial dependence" or reliance on a dominant customer, would negotiate at arm's length to arrive at a remuneration level fairly reflecting its value additive functionality. We would be concerned were the proposed deemed PE rule seek to re-examine or recharacterise commercial economics negotiated by arm's length counterparties.

We also note that New Zealand would intend to impose withholding tax on any royalty paid by the non-resident in respect of supplies made through the deemed PE. Such a royalty may well relate in part to other supplies made by other jurisdictions. We anticipate that apportionment would be necessary, which would again be difficult to calculate. Detailed guidance as to an apportionment methodology would be necessary should this aspect by introduced.

Paragraph 3.38 states that the current 100% abusive tax position penalty will apply for the purposes of the deemed PE rule. This appears to be an unduly harsh penalty for arrangements which are in compliance with current law for which it is currently proposed that no grandparenting is available. We consider Inland Revenue is significantly underestimating the time it will take for a multinational enterprise to reorganise its global supply chain.

We note the comments in the discussion document around a significant "lead time" between now and the introduction of the law. Notwithstanding such lead time we emphasise that there is currently no draft legislation or certainty around the time gap between publishing such draft legislation and effective date of final law. It is unrealistic to assume or expect taxpayers to restructure global operating models on the basis of a discussion document given the inherent uncertainty of what the actual law will say and the significant global commercial implications such a restructure would have.

We recommend that the potential for grandparenting or non-application periods for particular taxpayers be revisited.

Interaction with New Zealand's double tax agreements (paragraphs 3.40 to 3.45)

> The proposed permanent establishment avoidance rules may be inconsistent with New Zealand's DTA network, thereby creating uncertainty, deterring investment and undermining confidence in New Zealand's DTAs.

We agree that taxpayers should not be able to rely on DTAs to protect tax avoidance relations. We are not convinced, however, that the proposed anti-avoidance rule will only capture arrangements which should be treated as avoidance arrangements for the purposes of our DTAs.

In fact, the breadth of the proposed unilateral approach is likely to reduce confidence in the integrity of New Zealand's double tax agreements and to create uncertainty for foreign investment into New Zealand. There is inherent inconsistency between the alignment with suggested OECD approaches to international taxation (including but not limited to the adoption of the multilateral convention, including an enhanced PE definition) and the introduction of New Zealand-specific deemed PE provisions such as that suggested.

In addition, the proposals are arguably inconsistent with the generally accepted OECD approach of separate entity taxation that applies in respect of associated enterprises and has been agreed to by New Zealand in all of its DTAs. It is unclear how the proposals will apply in relation to the interaction between deemed PEs and the operation of the arm's length principle in respect of existing related party transactions. The proposals could potentially apply to transactions to which no actual New Zealand taxpayer is party.

More specifically, the proposals would impose new tests that are inconsistent with New Zealand's obligations under various existing DTAs. Tax could potentially be payable where a multinational operates a business structure that complies with existing DTA concepts of PE, within integrity measures agreed in our treaties and which meets the legal substance requirements of both parties to the DTA.

Where this occurs, it is likely that double taxation will occur, with MAP invoked. It appears possible to us that competent authorities would rule in favour of treaty provisions and the proposal's purported domestic law override would be invalid.

This uncertainty would reduce the effectiveness of the proposals as a base maintenance measure, while worsening the impact of the measures on inbound investment. In substance, little revenue may be gained while substantial inbound investment using new or innovative business models may be deterred.

Appendix B – Amendments to source rules

Permanent establishment source rule has potential to overreach (paragraphs 4.18 to 4.22)

> The permanent establishment source rule could tax foreign sourced income of non-residents, in contravention of New Zealand's international tax framework.

Income attributable to a PE and royalties that New Zealand can tax under a DTA will automatically be deemed to have a New Zealand source under the new rule.

While we understand that the intention in respect of this aspect is to ensure that there is not a "gap" between PE attributed income under New Zealand tax treaties and that may be taxed under our domestic source rules. However, it appears possible to us that such a rule could be indeed be drafted so as to deem, for example, a New Zealand source for the foreign-sourced income of non-residents. Taxing such income would be inconsistent with New Zealand's longstanding international tax framework and would go significantly beyond the stated purpose of the amendment. A DTA should not be used to create a tax liability where none would exist under domestic law.

The PE definitions contained in individual treaties will be used for the purposes of this rule (paragraph 4.19). Before final decisions are made on the design of the source rule, it would be helpful for Inland Revenue to analyse the definitions of PE across our treaty network, as we anticipate these will contain significant differences around, for example, building sites (6/12 months), natural resources, standing timber, or operating substantial equipment. Industry specific guidance may be helpful, as some sectors (such as film or technology) are particularly subject to disputes regarding PE status and income source.

Anti-avoidance source rule (paragraphs 4.23 to 4.28)

> There is a risk that the anti-avoidance source rule will extend to situations beyond those targeted by the OECD BEPS Action Plan.

We have no objection to a targeted anti-fragmentation and contract-splitting rule, consistent with the OECD's BEPS measures aimed at countering PE avoidance strategies.

The risk is that a rule treating the non-resident's income as having a source in New Zealand if it would have had a source, considering the non-resident's wholly owned group as a single entity will go beyond an anti-fragmentation rule. We consider that where a non-resident is earning income that has no domestic source there should be no tax. This is not a PE avoidance issue as in the absence of a New Zealand PE there is no need to even refer to the DTA. If drafted too broadly, it could seek to tax not only the New Zealand sourced income of the PE but also income derived by other group members with a New Zealand source where those other group members have no PE here (in effect, a "force of attraction" approach). We do not anticipate this is the intent but would welcome clarity on this point.

Life insurance source rule (paragraphs 4.29 to 4.35)

> The life insurance source rules should be changed by way of renegotiating the relevant DTAs.

While we understand what this proposed change is seeking to achieve, we consider this would be better achieved by a change to the relevant DTAs rather than via domestic law creating another boundary for life insurers to navigate.

Appendix C - Transfer Pricing

Broad support for direction of reform

We broadly supports better alignment of New Zealand transfer pricing rules with Article 9 of New Zealand's DTAs and the OECD Guidelines, which are an aid to interpret Article 9: Associated enterprises). Better alignment with Australian transfer pricing rules makes sense given the significant investment by Australian companies and to mitigate the potential for double taxation – but only to the extent those rules remain consistent with the principles set down by the OECD and do not seek to tax a greater than arm's length proportion of profit.

Transfer pricing definition (Paragraphs 5.7 to 5.9)

At paragraph 5.7, the document states that transfer pricing is a strategy used by multinationals to "shift profits out of New Zealand and reduce their worldwide tax bills". We are concerned this interpretation indicates a mind-set that multinationals generally target New Zealand taxable income through their transfer pricing strategy, which overstates the significance of New Zealand in global terms and understates the rigour imposed by the arm's length principle.

Transfer prices rules are defined in the 2016 revisions to the OECD Guidelines[2] as being concerned with determining the conditions, including the price, for transaction within an MNE group resulting in the allocation of profits to group companies in different countries. Transfer pricing might therefore be more neutrally defined as the setting of those prices (whether or not that results in the shifting of profits or a reduction in worldwide tax bills). Multinational enterprises cannot help but engage in transfer pricing, the concept itself is not tax driven and should not be used in derogative terms.

The in-market distributor structure (paragraph 5.16 and Appendix)

> The in-market distributor structure given in example 4 is overly simplistic. It leads to an interpretation that the Government considers all distributors with low profits to be problematic, where they happen to be performing distribution activities for a procurement hub in a jurisdiction with a lower corporate tax rate.
>
> Inland Revenue should clarify that using a limited-risk distributor ("LRD") has commercial justification. Use of the example without additional necessary factual information (e.g., regarding the risks actually borne by the respective parties) otherwise creates uncertainty.

Paragraph 5.16 of the discussion document refers to example 4 in the appendix, which relates to the use of an in-market LRD in New Zealand.

The LRD model is one commonly used throughout the world, including in New Zealand. It is especially prominent in the pharmaceutical and technology industries, where a large amount of research and development ("R&D") happens earlier in the supply chain in foreign jurisdictions. The distribution activity undertaken in New Zealand happens at the end of the supply chain and is often relatively low in terms of the value-adding functions contributing to the system profits of the enterprise.

[2] Executive summary, *Aligning transfer pricing outcomes with value creation:* OECD Final report on Actions 8-10.

OECD Guidelines (Chapter IX) recognise the LRD model and that companies may convert from full risk to limited risk models. Of course, consideration needs to be given to risk allocation and the revisions proscribe more emphasis on the economic substance of the structure. The structure should not be viewed as lacking "commercial reality"[3] simply because it is not a structure commonly seen between independent parties - yet the trade-off of risk and return is a fundamental commercial principle.

At paragraph 5.31, the discussion document quotes the revised OECD Guidelines as endorsing a substance-over-form approach to the allocation of risk. Viewed in isolation, this paragraph might suggest that contractual assumption of risk is not relevant to a transfer pricing analysis. However, the OECD Guidelines confirms that the contractual terms are the starting point in "delineating" a transaction, but not the only consideration.[4]

We endorse OECD's initiatives to ensure that transfer pricing outcomes are consistent with the location of value creation. We also support that under BEPS Actions 8-10 revisions, structures will need to be tested to ensure the pricing aligns with the economic substance of the transaction. However, the discussion document's commentary on the LRD structure is broad and is concerning in its wholesale designation of the LRD model as a form of profit-shifting (paragraph 5.16).

The implication seems to be that, in most cases, LRDs structures lack commercial reality and most risks are controlled by the New Zealand entity. Our experience is that invariably a substantial proportion of market risk is assumed and indeed controlled by the foreign principal (or other affiliates offshore). More often, marketing strategy is conducted offshore and tight control maintained over marketing spend, inventory levels and major business decisions of the LRD. The New Zealand subsidiary will often undertake market activation activity rather than development.

State of the law and reference to the OECD guidelines (Paragraphs 5.19 to 5.23)

> We support adding a reference to the OECD Guidelines into New Zealand's transfer pricing legislation but dispute this reference will "simply clarify our existing practice": it is not clear that Parliament intended the OECD Guidelines to be used as an interpretative aid to existing rules.
>
> Any law change to incorporate the OECD Guidelines should be prospective - both in law and in practice. It is not appropriate for Inland Revenue to apply the 2016 revisions to the OECD Guidelines to transactions that occurred before the publication of the revised Guidelines.

At paragraph 5.23, the discussion document states the OECD Guidelines are "generally consistent with our existing law" and that "Adding a reference to the OECD guidelines into New Zealand's transfer pricing legislation will simply clarify our existing practice of using the latest guidelines". We have previously argued in disputes with Inland Revenue that the current transfer pricing rules are not aligned with Article 9 and therefore some aspects of the OECD Guidelines do not sit well with the current New Zealand transfer pricing rules (similar to Australia following the decision in the *SNF*[5] case). While much of the OECD Guidelines are useful in assisting to interpret the arm's length principle under New Zealand transfer pricing law, there have been some areas of controversy caused by the non-alignment, notably around the extent to which arm's length prices should be subject to interpolated arm's length conditions. We do not agree that the OECD Guidelines can simply be referenced as an authority under current law. Inland Revenue practice of using the OECD Guidelines will not be

[3] Appendix, Example 4, page 51.
[4] See paragraph 1.78 of the revisions to section D.1.2.1.2 of the OECD Guidelines.
[5] Commissioner of Taxation v SNF (Australia) Pty Ltd [2011] FCAFC 74.

consistent with the existing transfer pricing law in all circumstances. It should be clear that any law change to incorporate the OECD Guidelines is prospective - both in law and in practice.

We have concerns that some of the 2016 revisions to OECD Guidelines brought about through Actions 8-10 are already being referenced by Inland Revenue for years prior to 2016. Concerns centre on the focus on economic substance, despite the discussion document confirming that existing transfer pricing legislation is focused on the legal form of arrangements (paragraph 5.15). We are not comfortable with Inland Revenue's current practice of applying all the 2016 revisions to the OECD Guidelines to preceding years. Such practice is applying changes retrospectively.

This is of further concern given we do not consider OECD Guidelines fully align with existing transfer pricing law, as noted above. The BEPS initiatives in Actions 8-10 are a substantial revamp of the OECD Guidelines and the revisions made in 2016 to the OECD Guidelines should not be applied retrospectively. A taxpayer cannot be expected to forecast substantive changes to OECD Guidelines when determining tax positions prior to 2016. Taxpayers take tax positions based on the information available to them, and it is unreasonable for Inland Revenue to challenge these tax positions armed with hindsight and a set of guidelines that never existed at the relevant time.

In support of our concerns regarding Inland Revenue's approach towards incorporating the OCED Guidelines, we refer to legislative history. The current transfer pricing rules were substantially enacted by the Income Tax Act 1994 Amendment Act (No. 3) 1995, and came into effect at the beginning of the 1996/1997 income year.[6] The rules effectively legislated the arm's length principle which had long since been a feature of Article 9 of New Zealand's double tax agreements ("DTAs"). In turn, the DTAs are largely modelled on the OECD Model Tax Convention.

Our domestic legislation in fact makes no reference to the OECD Guidelines. Parliament's original intention[7] was for the five available methods set out in section GC 13 to be consistent with the then OECD Guidelines (first released in 1995). Parliament did not, however, choose to make explicit reference to the OECD guidelines. Without explicit reference in the legislation, it is not clear how the 2016 OECD Guidelines are relevant for the purposes of the New Zealand transfer pricing rules.

We note that the position of the OECD Guidelines is unique in that they are not binding on member states of the OECD, and have not been ratified in domestic New Zealand law. The extent to which Inland Revenue uses them as an extrinsic aid to the legislation, assisting in the interpretation of section GC 13, is questionable. It is not supported by the legislation itself which provides no indication of how the five available methods are to be interpreted.

Since the passing of the legislation, the OECD Guidelines have expanded and changed considerably, most recently through the implementation of Actions 8-10 and 13 of the OECD's BEPS project. The drafters of section GC 13 could not have foreseen the changes that have since taken place.

As shown by the legislative history of section DB 34 regarding research and development,[8] it seems unlikely that Parliament would have contemplated the Income Tax Act 2007 be interpreted in light of

[6] Tax Information Bulletin [1210-110] *Arm's Length Principle*, 1 October 2000.
[7] Set out in the commentary on the Taxation (International Tax) Bill, August 1995.
[8] Section DB 34 which allows a deduction for expenditure incurred on research or development where that expense has been recognised for financial reporting purposes. Section DB 34 not only refers explicitly to the relevant reporting standard but has been consistently updated to reflect changes in generally accepted accounting practice and in the specific reporting standards. Notably, changes have been made in the Taxation (Business Taxation and Remedial Matters) Act 2007 and the Taxation (Consequential Rate and Remedial Matters) Act 2009. The failure of Parliament to consider incorporating specific reference to the OECD Guidelines materially weakens any Government arguments that the Guidelines should be seen as a strong aid to interpretation of section GC 13.

whatever guidance OECD produce on a prospective basis. Parliament did not delegate responsibility for New Zealand's transfer pricing rules to OECD officials; rather, it took note those in place at the date of enactment in the design of New Zealand's rules.

Aligning the rules with economic substance (paragraphs 5.24 to 5.33), requirement for arm's length conditions (paragraphs 5.41 and 5.42)

> We agree with the proposed changes to align the rules with economic substance. This reflects a step-change in the law and drafting of the legislation should set out unambiguously what is required of taxpayers, in order to demonstrate that all conditions of their transfer pricing arrangements are arm's length.

We have no issues with aligning the rules to economic substance in principle. In most respects the rules are already aligned to economic substance; present transfer pricing analyses necessarily involve preparation of a functional analysis.

However, reference to "arm's length conditions" would considerably broaden the scope of section GC 13. Inserting a rule to specify that taxpayers are required to take into account the relevant conditions that a notional third party would be willing to accept is likely to have a subjective and uncertain impact on many arrangements. While the Commissioner is entitled to make enquiries in assessing arm's length terms and conditions, a commercial negotiation will take into account many factors. Given that the burden of proof will fall on taxpayers to show that the conditions of their arrangements are arm's length, it is important that Inland Revenue is clear about what is required of taxpayers.

Reconstruction of transactions (paragraphs 5.34 to 5.40)

> We submit that the test under which the Commissioner should be able to reconstruct transfer pricing arrangements must have a high threshold, consistent with the OECD Guidelines.
> New Zealand's legislation should refer to "exceptional circumstances" or provide similar wording that ensures it is only used where the arrangement is aggressive and/or commercially irrational.
>
> Adjustments which propose to reconstruct transactions should have a high level of sign-off internally within Inland Revenue, in the same way as our domestic avoidance laws.
>
> In conducting investigations, Inland Revenue looks at such arrangements retrospectively. It is important that the merits of any commercial decisions taken prospectively are not labelled irrational by the Commissioner who has the benefit of hindsight simply because they turn out to be unsuccessful.
>
> Inland Revenue should release robust guidelines to assist taxpayers on factors it will take into account in considering reconstruction; along with useful examples.

The discussion document proposes to grant Inland Revenue a wider mandate to reconstruct arrangements than that contemplated by OECD, similar to that adopted in Australia. According to paragraph 5.39, the proposed reconstruction rules would not be explicitly limited to "exceptional circumstances". Dropping the "exceptional circumstances" condition (which exists in the OECD Guidelines[9]) suggests that Inland Revenue would seek to reconstruct a transaction if a taxpayer cannot "benchmark" those particular dealings against those seen in the market between independent parties. We have concerns that taxpayers will be required to demonstrate that such dealings occur between

[9] D.2.1.121-125.

unrelated parties and the transaction is "commercially rational". Non-recognition or reconstruction will inevitably result in more international disputes and need for international dispute resolution.

The revised OECD Guidelines emphasise the problems inherent in reconstruction. Specifically, paragraph 1.123 of the revised part D.2 of the OECD Guidelines states:

> *"Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured. It should be noted again that the mere fact that the transaction may not be seen between independent parties does not mean that it does not have characteristics of an arm's length arrangement."*

Given the serious risk of double taxation, we consider that reference should be made in the reconstruction rules to be explicitly limited to exceptional circumstances. New Zealand's reputation as a good place for doing business depends in part on fair and certain regulation.

Wording along the lines of the Australian rules, i.e., that "independent entities dealing wholly independently with another in comparable circumstances would not have entered into the actual commercial or financial relations" will create considerable uncertainty for taxpayers. This is because this wording does not take account of the fact that associated enterprises do commonly enter into actual commercial or financial relations which would differ from those entered into by independent parties. It is only where the circumstances of such an arrangement are commercially irrational that the rule should be invoked. Section 1.123 of the revised OECD Guidelines states that the key question is whether the actual transaction possesses the commercial rationality of arrangements that would be agreed between unrelated parties *under comparable economic circumstances, not whether the same transaction can be observed between independent parties.*

Paragraph 5.40 of the discussion document acknowledges that the rule will reduce certainty for taxpayers, but should only be the case where the arrangement is aggressive and commercially irrational. If that is the case, then we consider that the legislation should say so. If the concept of an "exceptional circumstance" is subjective, then perhaps some other word or phrase conveying the relevant meaning could be used.

Paragraph 5.35 of the discussion documents states that "if the commercially rational alternative is that an independent business would not enter into a similar arrangement, it may make sense to disregard (rather than reconstruct) the arrangement for tax purposes." This could present worrying outcomes. In most cases, Inland Revenue will be investigating retrospectively and would need to exercise caution that its conclusions as to whether an arrangement is commercially rational is not prejudiced by the benefit of hindsight, which a taxpayer entering into the arrangement would not have.

There is risk Inland Revenue will assert that an arrangement cannot be commercially rational simply because it is not seen in practice between unrelated parties. Inland Revenue needs to be cognisant of the important principle emphasised in OECD that cautions tax authorities to take into account that multinationals often enter into transactions that are rarely encountered between by independent parties.

Further, we note that disregarding an arrangement entirely should be rare. If an arrangement giving rise to a deduction is considered to be commercially irrational, the relevant counterfactual might not be the lack of any deduction at all. It might be that, but for the arrangement, the taxpayer would have entered into an alternative, commercially rational arrangement, which might have yielded a lesser deduction. Disregarding the arrangement entirely would therefore be unjust. We defer to the revised

OECD Guidelines which provide additional guidance as to when arrangements should be disregarded, and note that these examples are limited in scope (see for example, those at section D.2.).

Advance Pricing Agreements

APAs should remain unaffected by any law change until such time as the APA is required to be renewed.

While the proposed law changes will be prospective in effect, this could well impact APAs that have been negotiated and signed under the current law, yet will be subject to any law change.

Given that APAs, by their nature, are approached in good faith by a taxpayer to get certainty for a period of time, all APAs should remain unaffected by any law change until such time as the APA is required to be renewed.

Burden of proof (paragraphs 5.43 to 5.48)

If the taxpayer is to bear the burden of proof in relation to transfer pricing, we consider that Inland Revenue should be more prescriptive around what is required by way of evidence. Documentation requirements should be set out in some formal way (rather than through webpages on the transfer pricing section of Inland Revenue's website).

The risk of arrangements being reconstructed or disregarded (and deductions being denied) is serious for taxpayers who, under the proposals, bear the burden of proof in relation to showing that the conditions of their associated party transactions are arm's length. We submit that Inland Revenue will need to provide some guidance about what evidence should be provided. The proposed rules will necessarily increase compliance costs, with more robust transfer pricing documentation required.

The discussion document notes at paragraph 5.48 that the additional compliance costs imposed by a shift of the burden of proof would not be substantial. That may be so if the burden of proof was the only change. However, coupled with the need for taxpayers to show that all conditions of their cross-border associated party transactions are arm's length, the risk that Inland Revenue could reconstruct their cross-border arrangements and other measures such as the extended statutory time bar, the compliance costs for taxpayers will be substantial. We envisage that these proposals will add considerable expense for multinational companies and will likely increase the occurrence of disputes with Inland Revenue.

The additional expense might be mitigated if Inland Revenue set out more clearly what is required from taxpayers and what is not. Documentation supporting *all* conditions of a transfer pricing arrangement could encompass an almost unlimited amount of analysis. Inland Revenue would need to consider which conditions it deems to present more material risk, and what taxpayers must do to demonstrate that any given condition is appropriate.

One specific area on which guidance from Inland Revenue would be helpful is that of the use of the profit split method.

The OECD's Revised Guidance on Profit Splits[10] states at section C.3 that *"the application of a transactional profit split of actual profits reflects a relationship where the parties either share the same economically significant risks associated with the business opportunity or separately assume closely related risks associated with the business opportunity and consequently should share in the resulting profits or losses".* In particular, profit splits are deemed to be more appropriate where multiple parties make unique and valuable contributions such as unique and valuable intangibles.[11]

We are concerned that the increasing transparency over a taxpaying group's entire supply chain in transfer pricing matters and information-gathering powers given to the Commissioner in the proposals will lead to Inland Revenue increasingly seeking to use the profit split method for New Zealand taxpayers in circumstances beyond those envisaged by the OECD.

We are finding in practice that, in obtaining more information about the group's supply chain, Inland Revenue is proposing using the profit split method where we would not have considered it appropriate. We are concerned that, using additional powers to force taxpayers to pay tax early, Inland Revenue could devise profit splits using somewhat arbitrary calculations based on visibility of the group's global supply chain (and where the role of the New Zealand entity in that supply chain is neither particularly unique nor valuable). Not only is Inland Revenue's use of the profit split method sometimes problematic, the resulting calculations regarding attributable profit can often be unsustainable. For example, a technology company is unlikely to have been able to allocate losses to New Zealand in its development phase, so application of the profit split method as soon as profits eventuate can lead to inequitable outcomes. Further guidance is needed from Inland Revenue on its use of the profit split and other methods; in practice we consider that its use can often be contrary to the relevant OECD guidance.

General requirement to document transfer pricing practices (paragraphs 5.60 to 5.63)

> We submit Inland Revenue should provide guidance to taxpayers on when transfer pricing documentation needs to be prepared, and what the documentation ought to contain.
>
> One approach would be to provide some de minimis rules to allow taxpayers to prepare simplified documentation, along the lines of the simplified record keeping requirements in Australia. Taxpayers with a small amount of related party transactions should be able to take a cost/risk approach to documentation without concern of a potential shortfall penalty.

Multinationals often ask us whether transfer pricing documentation is required by New Zealand legislation, whether there are monetary thresholds for preparing transfer pricing documentation, and what the penalties are for non-compliance. These questions are driven by taxpayers' experience in other jurisdictions, where the legislation clearly sets out these matters. In New Zealand the answer is less clear, because:

- Transfer pricing documentation is not explicitly required by legislation, but rather in practice required by Inland Revenue as evidence that taxpayers have exercised reasonable care;
- Monetary thresholds for which documentation is required are not explicitly stated; rather Inland Revenue considers that transfer pricing documentation should reflect the level of risk (without stating what level of risk is material)[12];

[10] Issued 5 September 2016.
[11] See section C.3.2.
[12] See paragraphs 317ff of the New Zealand transfer pricing guidelines.

- Penalties are calculable with respect to any tax shortfall (not whether transfer pricing documentation has been prepared at all), for example where the taxpayer has not taken reasonable care.

New Zealand's self-assessment regime therefore places a larger burden on taxpayers to determine for themselves whether their cross-border associated party transactions are material, and the level of documentation that is appropriate. Some multinationals are not well-equipped to determine what the New Zealand Government would deem to be material. What is material for one revenue authority can be insignificant for another.

Further, multinationals often determine their transfer pricing obligations centrally. They must enquire into the transfer pricing rules of a large number of jurisdictions, and require straightforward answers as to what level of documentation is required in each. If the requirements are vague and complex, as they arguably are in New Zealand, on a cost/risk basis the multinational may decide only to prepare transfer pricing documentation for those countries whose law explicitly requires it.

At paragraph 5.61, the discussion document is critical of the varying quality of documentation prepared by taxpayers. In our experience, multinationals generally prepare their transfer pricing documentation consistent with the OECD Guidelines. Inland Revenue has not specifically stated what it would like to see included in transfer pricing documentation. It did produce its own transfer pricing guidelines (the "IRD Guidelines").[13] However, it has now stated its intention not to further update the IRD Guidelines and instead follow the 2010 OECD Guidelines.[14] This begs the question: what would Inland Revenue like to see in the documentation (other than what the OECD Guidelines prescribe)?

In summary, the present transfer pricing rules do not adequately describe to taxpayers:

- How the arm's length standard is to be interpreted and how the five available methods should be applied (i.e., whether the OECD Guidelines are authoritative, and if so, which version);

- When taxpayers are required to prepare transfer pricing documentation to comply with the law;

- What documentation should contain so as to satisfy the Commissioner that the taxpayer has taken reasonable care in determining its transfer prices.

Inland Revenue is not proposing any compulsory filing of transfer pricing documentation. It will expect transfer pricing documentation, such as a master file and local file, to be provided on request or audit. Experience in Australia under its new transfer pricing laws is that the level of document compliance has increased. Given alignment of the transfer pricing rules with those of Australia, and the concerns we express above, the Government should consider providing some de minimis rules to allow taxpayers to prepare simplified documentation, along the lines of the simplified record keeping requirements in Australia. Taxpayers with a small amount of related party transactions should be able to take a cost/risk approach to documentation without concern of a potential shortfall penalty.

[13] An appendix to *TIB* Volume 12, No 10 (October 2000).
[14] See for example: http://www.ird.govt.nz/transfer-pricing/transfer-pricing-guidelines.html.

Time bar extension (paragraphs 5.67 to 5.72)

We oppose the extension of the time bar for transfer pricing matters. The fact-specific nature of a transfer pricing dispute is neither unique to transfer pricing nor justification for the extension.

The discussion paper suggests that an extended time bar would bring New Zealand in line with other jurisdictions. The paper points to Australia and Canada which have time bars that are three years longer than their four year time bars for other tax matters. We note from the table given at paragraph 5.70 that there are several other jurisdictions which have the same time bar for transfer pricing as they do other tax matters; so New Zealand is by no means out of step with the world.

The discussion document seeks to draw a distinction in relation to transfer pricing assessments which are more dependent on the facts and circumstances of each case than other tax matters. Other tax matters also are dependent on facts and circumstances; the avoidance regime would be one example where factual inquiries are more necessary and yet the time bar remains the same.

It should also be noted that a longer time bar creates the same difficulties for a taxpayer trying to defend its tax position as it does for the Commissioner. This is particularly pronounced where, for example, the taxpayer has since restructured or closed their New Zealand operations and there are no longer staff in New Zealand with institutional knowledge of the taxpayer's operations.

Further, the extension of the time bar would be inconsistent with Inland Revenue's other moves towards real-time tax compliance. It is contrary to the scheme and purpose of Inland Revenue's Business Transformation programme. We also note that participation in the Inland Revenue's APA programme has been strong in recent years, reflecting a willingness on the part of both the Commissioner and taxpayers to settle transfer pricing matters contemporaneously, rather than engage in costly and lengthy disputes.

Many other changes are proposed in the discussion document which assist the Commissioner in assessing multinationals on their international tax obligations. We consider that implementation of the statutory time bar could be deferred until the full effect of the other proposals is seen.

If the proposed extension of the time bar does go ahead, it should not unfairly reopen any previously closed periods. For example, tax positions assessed in the year ended 31 March 2013 will now be time barred, but could be reopened for a further three years unless any change is prospective.

Inland Revenue should provide more substantive rulings and guidelines to assist taxpayers

Inland Revenue should provide some specific guidance to complement OECD Guidelines in the New Zealand context. This guidance should be in the form of detailed rulings or interpretation statements rather than informal website updates. Guidance would be particularly important regarding suitable comparables for benchmarking, and the circumstances in which Inland Revenue views particular methods such as profit split as the most reliable transfer pricing method.

Although not specifically covered in the discussion document, with more complexity and uncertainty in Action 8-10 revisions, we urge Inland Revenue to prepare detailed rulings, interpretation statements or similar guidance in consultation with transfer pricing practitioners. The Australian Tax Office typically assists taxpayers by preparing rulings and other interpretation statements for their transfer pricing rules (for example TR2014/6 relating to section 815-130). These rulings tend to provide explicit justification for departures from OECD Guidelines and follow a transparent consultative process with an opportunity for taxpayers and advisors to submit their views.

Inland Revenue released final transfer pricing guidelines in October 2000[15] but has ceased updating them. It has more recently relied on website updates, which contains relatively scant detail, have unclear authoritative value, are not widely publicised and may be removed from the website at any time. To ensure better compliance and less controversy, with these changes in law, we recommend Inland Revenue provide some specific guidance to complement OECD Guidelines in the New Zealand context.

Fundamental to the OECD Guidelines is comparability. Difficulties in benchmarking comparables for New Zealand companies typically requires taxpayers to seek comparables in geographies outside New Zealand. Inland Revenue has previously suggested (via EY Global transfer pricing surveys) a hierarchy of geographies in terms of reliability of comparables (e.g., Australian companies have traditionally been considered the best geography to search for comparables and Asian countries the least). More recently we have noticed in practice Inland Revenue has been presenting benchmarking based on a wide geographical spread of comparables contrary to previously stated guidance. Further written guidance would be useful to minimise risk of dispute.

The administrative measures proposed in chapter 6 of the discussion document will give Inland Revenue more power to seek information held offshore about a multinational group's affairs and to apply sanctions for non-cooperation. We acknowledge the need for Inland Revenue to be able to collect sufficient information in a timely manner to audit transfer pricing matters, but do have concerns about how the information is used. In particular, and as referred to above, visibility of a multinational group's global supply chain is not in itself adequate justification for the use of the profit split method. The additional administrative measures therefore confer a responsibility on Inland Revenue to provide some robust guidance on transfer pricing matters, including use of the profit split, so that taxpayers can ensure that they are meeting Inland Revenue's expectations of transfer pricing analysis and documentation.

[15] Tax Information Bulletin, Vol 12, No 10, October 2000, appendix

Appendix D - Administrative measures

Cooperation and resourcing (paragraphs 6.1 to 6.18)

We submit that many of the proposed administrative measures could better be resolved by additional resourcing of Inland Revenue's transfer pricing and investigations teams. The administrative measures proposed would give the Commissioner substantial powers to issue an assessment and avoid many formalities of the existing disputes process. We consider that these powers overreach in light of the other proposals advanced, such as the shifting of the burden of proof to taxpayers.

We acknowledge that collection of information in transfer pricing audits is time consuming and draws heavily on both Inland Revenue and taxpayer resources. In practice, most multinationals are cooperative with Inland Revenue: it is in their interest to resolve disputes quickly and with certainty. In our experience, Inland Revenue as well as the taxpayer will cause delay. Delays are caused by lengthy periods waiting for Inland Revenue to respond and information requested proving not to be of much assistance to Inland Revenue, thereby requiring alternative information to be requested. We suggest some protocols and guidelines be put in place, agreed with transfer pricing practitioners, around transfer pricing audits so taxpayers can also be assured that matters will be dealt with expediently and Inland Revenue positions reached within a reasonable period of time, with reasonable clarity and with least possible disruption to the taxpayer group.

The majority of problems noted above could be resolved through resourcing. Powers to gather more information will worsen transfer pricing administration unless Inland Revenue is able to deal with that information on a timely basis.

We are concerned that resourcing issues will be exacerbated by the implementation of other proposals in the BEPS package. In particular, we consider that interaction of the interest rate cap and transfer pricing rule changes will lead to a larger number of cross-border disputes, double taxation and MAPs. We are concerned that Inland Revenue will not have sufficient resources to devote to these requests and procedures. It would be concerning if the Commissioner uses her new administrative powers to push seemingly "uncooperative" taxpayers further into the disputes process due to a lack of available resources at the investigation end.

Assessments (paragraphs 6.19 to 6.20)

Should the proposal for Inland Revenue to issue a NOPA or assessment based on information available at the time proceed, a taxpayer should be able to challenge that assessment.

At paragraph 6.19, the discussion document proposes that Inland Revenue be able to issue an assessment based on the information available to Inland Revenue at the time. As a drafting matter, it seems likely that this would need to be added as an exception to section 89C of the Tax Administration Act 1994, which provides the circumstances in which the Commissioner may make an assessment without first issuing a notice of proposed adjustment ("NOPA").

Further, we note that, all other things being equal, section 138E(1)(e)(iv) would operate to ensure that there would be no right of challenge against a decision of the Commissioner. This is concerning given the potential gravity of a taxpayer being caught by the rule and having an assessment made against them. The proposal could be seen as draconian given that the Commissioner's decision would not be reviewable. Other than that it would need to be signed off by a senior member within Inland Revenue, there seem to be few safeguards to stop Inland Revenue issuing an assessment based on relatively subjective criteria.

Payment of tax in dispute (paragraphs 6.21 to 6.26)

We submit that this measure should not proceed:

- Large multinational enterprises are unlikely to default on tax due
- At current rates, use of money interest will not compensate taxpayers should Inland Revenue's position not be confirmed

Should our main submission be declined, purchases of tax from a tax pooling service should be accepted as payment of tax.

It is important to consider the position of a taxpayer against whom an assessment is issued under the new rules. In such a case, the taxpayer would have to challenge the assessment in Court. Even if it succeeds, it would then only receive the Commissioner's paying rate of interest on the tax recovered. Given that the Commissioner initiated the dispute the current rate of 1.02% per annum[16] this effectively penalises the taxpayer through no fault of its own.

The purpose of the use of money interest regime is stated in section 120A of the Tax Administration Act and includes compensating taxpayers for the loss of use of money through their paying too much tax. Further, interest payable under the regime is not a penalty.

The proposals only affect large multinationals with revenue of over EUR750 million. Generally these taxpayers do not default on tax payments. Yet, under the current disputes regime, the Commissioner can recover interest at the taxpayer's paying rate which reflects a higher credit risk than these types of taxpayers actually represent to Inland Revenue. It is unclear why upfront payment of tax would really be necessary for these taxpayers when the use of money interest regime already adequately compensates the Commissioner.

Further, no reason has been advanced for why purchases from a tax pooling services should not be accepted as payment of the relevant tax. Denying pooling as an option seems to support that the use of money interest regime is in fact being used to impose a penalty rather than incentivise the correct payment of tax. We submit that purchases of tax from a tax pooling service should be acceptable.

Collection of information (paragraphs 6.29 to 6.37)

We submit that section 21 should have an exception for information which is subject to legal privilege.

Drafters of the legislation will need to take particular care in relation to the expansion of section 21 of the Tax Administration Act, as described at paragraph 6.37 of the discussion document. One concern is the position of tax advice which is subject to legal privilege. In some circumstances, the Commissioner will request information from a taxpayer in a section 21 request and the taxpayer might have legally privileged advice which arguably falls within the ambit of the request. In such a case, the taxpayer should not be required to disclose the document, but not doing so might affect its ability to later waive privilege should it wish to use the documents as admissible evidence in court.

[16] From 7 May 2017