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27 April 2017

BEPS – Transfer pricing and permanent establishment avoidance
c/- Deputy Commissioner, Policy and Strategy
Inland Revenue
PO Box 2198
WELLINGTON

Dear Cath

BEPS – TRANSFER PRICING AND PERMANENT ESTABLISHMENT AVOIDANCE

We are writing to submit on the Government Discussion Document, *BEPS – Transfer pricing and permanent establishment avoidance,* (the "discussion document"). In particular, our submission relates to the proposed changes to the life insurance source rules (the "proposed changes").

We appreciate the opportunity to submit on the discussion document and would be happy to meet with Officials to discuss any of the matters raised in this submission further.

Summary

We submit that:

- The proposed changes place an onerous and unfair burden on New Zealand life insurers to have completeness of information regarding a non-resident reinsurer's place of tax residence and/or whether the non-resident reinsurer has a New Zealand permanent establishment. This seems a disproportionate response to what we would regard as a remote risk.

- Double tax agreements ("DTAs") operate to, among other things, protect a company from the risk of double taxation. A unilateral change to domestic legislation can deny a company the ability to rely on a DTA for protection from double taxation. The proposed change to deny deductions to a New Zealand life insurance company, represents an unfair and unilateral reconstruction of the tax treatment of life reinsurance and gives rise to what is in effect a double taxation, with no ability to rely on the relevant DTAs or the protection mechanisms within those DTAs. The appropriate response to this risk would be to amend the relevant DTAs.

- The proposed changes could have significant adverse economic implications to the tax treatment of existing life reinsurance contracts (where the reinsurer is resident in Singapore, Canada and Russia, and does not have a New Zealand permanent establishment) and unfairly penalises New Zealand reinsured life insurance companies. Life insurance reinsurance agreements are typically long term agreements. New Zealand life insurance companies will typically not be in a position to renegotiate such agreements part way through the term of the agreements. Therefore, should the proposed changes proceed, they should be restricted to life reinsurance contracts entered into after the enactment of the changes with reinsurers who are resident in Singapore, Canada and Russia and who do not have a permanent establishment in New Zealand. The rules should not apply for existing contracts or for contracts where the reinsurer, subsequent to entry into the reinsurance contracts, changes its tax status by losing its permanent establishment in New Zealand and/or becomes resident in Singapore, Canada or Russia.

Life insurance source rules

Article 7 of New Zealand's DTAs provide relief to non-residents such that, broadly, New Zealand is prevented from taxing business profits earned by a non-resident unless they are attributable to a permanent establishment in New Zealand. However, New Zealand DTAs (with the exception of New Zealand's DTAs with Canada, Russia and Singapore) specifically exclude income from insurance with non-resident insurers from this Article.

Therefore, in most cases, New Zealand has a taxing right on any life insurance contract which is entered into or offered in New Zealand by a non-resident life insurer. However, New Zealand's DTAs with Canada, Russia and Singapore do not exclude income from insurance so a non-resident life insurer in those jurisdictions (with no permanent establishment in New Zealand) will not be subject to New Zealand taxation on life insurance contracts entered into or offered in New Zealand.

Proposed changes to life insurance source rules

Officials concern seems to be that there may be tax relief for New Zealand sourced insurance income if the reinsurer is resident in Singapore, Canada or Russia, and does not have a permanent establishment in New Zealand. In response to this concern, the discussion document proposes the following amendments to the Income Tax Act 2007:

- *Section DR 3*
  The section is to be amended to specifically provide that no deduction is available for the reinsurance of policies if the premium income on that policy is not taxable in New Zealand (including under a DTA).

- *Section EX 28*
  The definition of a FIF included in the section is to be amended to specifically provide that New Zealand residents are subject to the FIF rules in respect of policies that are not subject to New Zealand tax under the life insurance rules or any applicable DTA.

Essentially, the proposed changes seek to deny deductions for the reinsured party in circumstances where the reinsurance premium income is not taxable in New Zealand (due to DTA relief provided to reinsurers under New Zealand DTAs with Canada, Russia and Singapore).

Adverse impact of the proposed changes

New Zealand life insurers cannot be expected to have completeness of information regarding a reinsurer's place of tax residence or whether the offshore insurer has a New Zealand permanent establishment. The proposed drafting places an unfair burden on the New Zealand life insurers to confirm the tax residence of the reinsurer. If the reinsurer is resident in Canada, Russia and Singapore, the New Zealand life insurer may not be in a position to renegotiate their reinsurance contracts. Furthermore, a reinsurer's tax status can change during a contract. It is unfair to penalise an insured part way through a contract by denying deductions for premiums.

Proposed changes are contrary to international tax principles

In general, double tax agreements ("DTAs") operate to allocate taxing rights between contracting states. One of the objectives of DTAs is to protect a company from the risk of double taxation. Double taxation occurs when two jurisdictions seek to tax the same source of income. Where this occurs a company can often rely on a DTA to protect them from tax in one of the jurisdictions. DTAs also provide mechanisms, such as the mutual agreement procedure ('MAP'), for countries to determine which country has the right to tax income.

Despite DTAs, a unilateral change to domestic legislation can deny a company the ability to rely on a DTA for protection from double taxation. In particular, if a country denies a tax deduction for a particular expense, where that amount is taxable abroad effectively gives rise to double taxation.

We would submit the proposed change to deny deductions to a New Zealand life insurance company, represents an unfair and unilateral reconstruction of the tax treatment of life reinsurance and gives rise to what is in effect a double taxation. The result of this change also leaves a NZ life insurance company, subject to these changes, with no ability to rely on the relevant DTAs or the protection mechanisms within those DTAs. We would also submit that the appropriate response to this risk would be to amend the relevant DTAs.

Grandparenting

The current tax treatments of reinsurance contracts have no doubt informed decisions taken when entering into existing insurance contracts. While uncertainty and risk is of course inherent in any long term agreement, particularly over an extended horizon like that used for life reinsurance contracts, we consider that it is a legitimate expectation of life insurer that they should be able to continue under reinsurance arrangements for the remainder of their terms without being subject to significant changes in tax policy.

Therefore, we submit that it is important that grandparenting treatment is adopted such that reissuance arrangements that existed before the enactment of the proposed changes are not subject to them. Furthermore, effective grandfathering treatment should apply if the tax status of the reinsurer changes during the contract.

For any queries in relation to this submission, please contact Teresa Farac (+64 9 303 0845 or tfarac@deloitte.co.nz).

Yours sincerely

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Teresa Farac
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