

NATIONAL FOREIGN TRADE COUNCIL, INC.

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BEPS – Transfer pricing and PE avoidance C/-
Deputy Commissioner, Policy and Strategy Inland
Revenue Department PO Box 2198 Wellington 6140

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

Submission re: BEPS - Transfer Pricing and Permanent Establishment Avoidance Discussion Document

Dear Deputy Commissioner, Policy and Strategy:

On behalf of the National Foreign Trade Council (the “NFTC”), we appreciate this opportunity to submit comments with respect to the “BEPS -Transfer pricing and permanent establishment avoidance” discussion document (the discussion document).

The NFTC, organized in 1914, is an association of approximately 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial and service activities and the NFTC therefore seeks to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. The NFTC’s emphasis is to encourage policies that will expand U.S. exports and enhance the competitiveness of U.S. companies by eliminating major tax inequities in the treatment of U.S. companies operating abroad. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment and through direct investment in facilities abroad. Foreign trade is fundamental to the economic growth of U.S. companies

The NFTC appreciates the willingness of the New Zealand Department of Inland Revenue (Inland Revenue) to request and consider comments regarding the discussion document. Contrary to the assertion made in paragraph 1.4 that “[t]hey are not intended to make any fundamental changes to the current international tax framework”, the NFTC believes the discussion document diverts from international norms and the OECD Base Erosion & Profit Shifting (BEPS) Action Plan in which New Zealand agreed and actively participated. The NFTC agrees with the statement in paragraph 1.5 that “It is important to enforce the

integrity and efficiency of the tax system in designing tax policy so that there is a level playing field.” However, while seemingly justifying the proposals in the discussion document by reference to Australian and UK efforts, enactment of the unilateral actions in the discussion document will make New Zealand an outlier, increase tax uncertainty, negatively affect foreign direct investment into New Zealand, and may lead to other countries enacting unilateral actions that erode progress made in the BEPS Action Plan.

A summary of the NFTC’s major points and recommendations are as follows:

Source and permanent establishment avoidance

- 1 The NFTC believes the proposed PE Anti-Avoidance Rule “deeming” a non-resident entity to have a permanent establishment in New Zealand if a related entity carries out sales activity in New Zealand will apply to non-abusive common regional sales structures with New Zealand sales and support entities that are appropriately compensated. This subjective proposal ignores legal entities, is outside of the OECD BEPS Action Plan, will apply to common non-abusive regional sales structures, and creates significant uncertainty and unnecessary disputes with taxpayers and between New Zealand and its trading partners.
- 2 If Inland Revenue believes these local sales support activities are not appropriately compensated, the NFTC believes the analysis should be considered under the transfer pricing guidelines rather than subjectively “deeming” a permanent establishment which may or may not have any additional profit attributable to the PE.
- 3 The reference in paragraph 3.24 regarding “[w]hether the arrangement has any of the indicators of PE avoidance, such as the involvement of a low tax jurisdiction, specialized services, or a related entity which is allocated a low amount of profit on the basis it is carrying out low value activities while having a number of well paid employees”, illustrates that any concerns should be considered using a transfer pricing analysis rather than creating a ‘deemed’ PE. Contrary to the statement made in paragraph 3.26 that “[i]t is not intended to deem a PE to exist where one does not in substance”, the discussion document does just that.
- 4 The helpful examples in the Appendix actually support the case that any New Zealand concerns should be addressed via a transfer pricing analysis rather than “deeming” a PE.
- 5 In example 1, a direct sale by a non-resident from offshore does not create New Zealand source income or a deemed New Zealand permanent establishment. As mentioned, “[f]rom a policy perspective this outcome is entirely in accordance with the current norms of international taxation which New Zealand – as well as other countries – follow.” The NFTC agrees.
- 6 However, in Example 3, a direct sale from offshore with in-market sales activities would, as a result of the discussion document “ensure that the New Zealand subsidiary’s sales activity created a PE for the non-resident; deem the non-resident to supply its goods or services through the PE; ensure the non-resident’s sales income had New Zealand

source; and allow New Zealand to apply NRWT to the royalty paid by the non-resident to the related entity resident in the no tax jurisdiction under any applicable DTA.” The discussion document notes: “[u]nder the in-market support structure, the New Zealand subsidiary is paid a fee for its services, but this fee generally only exceeds its costs by a small margin.” The NFTC submits that this is a transfer pricing issue rather than a permanent establishment issue. As a matter of policy, ignoring legal structures and “deeming” a PE for customary and non-abusive in-market sales activity, will create substantial uncertainty and may result in the non-resident eliminating local sales support functions to minimize PE risk to the detriment of the New Zealand economy and consumers

- 7 In addition, the NFTC believes that applying the subjective rule in the discussion document to “deem” a permanent establishment “under an arrangement in which those goods or services are to be on-sold to customers in New Zealand by a third party (whether related or not)”, will create additional uncertainty and PE risk that may negatively affect a non-resident’s decision to participate in the New Zealand market. The NFTC is concerned about the unpredictability and uncertainty caused by enacting domestic legislation which overrides the OECD PE standard. In this regard, the statement in 3.45 that the “PE avoidance rule would apply notwithstanding anything in the DTA” seems contradictory to the statement in 3.2 that “the proposed rule is not intended to widen the accepted international definition of PE in substance”. There is also an explanation in Section 3.15 that the domestic rule is being considered to address situations where a DTA does not exist or where the “broadened” language is not accepted in the DTA. The PE standard being considered for adoption is admittedly broader than the OECD definition.
- 8 The term “third party” buyer in the factors listed in 3.27 should be defined consistently with the description in 3.31 which carves out of the rule entities which purchase goods from a non-resident and independently sell them to third parties. In 3.27, the third bullet should clarify that “carrying out an activity related to the sale” does not apply when the buyer is independently selling to third parties. Otherwise the language in 3.27 is ambiguous. The definition of an independent third party should exclude third parties who are not managed or controlled by the offshore seller or are publically traded.. In these instances, it is not possible to offer sales of supplies on other than arms-length terms.
- 9 In the bullet point 3.24 where the application of the rule is discussed, the specific bullet addressing the nature of the services carried out should indicate that the rule would potentially apply only where the services include locating customers, promoting products to those customers, discussing the customer’s needs and tailoring the product to be sold for the customer, and indicating pricing and delivery dates and other key terms to the customer”, to be consistent with the example in 3.26.
- 10 Regarding the interaction with New Zealand’s double tax agreements, paragraph 3.45 provides “ [w]e propose providing that our PE avoidance rule would apply notwithstanding anything in a DTA.” The NFTC believes such unilateral action will

further erode the tax treaty network, erode international tax norms, and result in more tax disputes between New Zealand, taxpayers, and New Zealand's international trading partners.

Chapter 5: Strengthening the transfer pricing rules

- 11 Paragraph 5.69 notes that “[I]t can be difficult for tax authorities to adequately identify the risk, apply the arm’s length principle and amend the relevant tax return within four years.” Citing Australia and Canada as precedent for a seven-year time bar for transfer pricing, the discussion document proposes increasing New Zealand’s time bar for transfer pricing matters to seven years.
- 12 The NFTC believes the difficulties identified in the discussion document should be adequately addressed by the Government’s proposal to shift the burden of proof from the Commissioner to the taxpayer in transfer pricing matters. Extending the time bar to seven years in transfer pricing cases will increase uncertainty, delay timely resolution, and add to the inventory, time, and administrative costs for New Zealand and its treaty partners. A reasonable time bar benefits both taxpayers and tax administrators by not overly prolonging a transfer pricing determination. As such, the extension of the time bar should not proceed.
- 13 If the time bar extension does proceed, consideration needs to be given to the interaction of the extended time bar for transfer pricing matters, the impact on competent authority cases, and the time bar applicable for other purposes. An adjustment for transfer pricing could also have an impact on withholding tax and income tax. The NFTC is concerned that extending the time bar for transfer pricing matters may result in unintended consequences including a de facto extension of the time bar for other tax types, an inability for taxpayers to claim offsetting adjustments when transfer pricing matters are reassessed, and a growing inventory of expensive and prolonged competent authority cases for New Zealand and other governments.

Chapter 6: Administrative measures

Non-cooperation

- 14 Chapter 6 proposes to introduce new administrative measures that would apply to large multinationals as a result of non-cooperation. The proposed measures include the ability for Inland Revenue to issue an assessment based on information held at the time; and impose penalties for failure to comply with information requests.
- 15 The discussion document states in paragraph 6.17 that the proposed rules are not intended to impose unreasonable demands on multinationals. However, some of the factors put forward in the proposal in paragraph 6.16 are sufficiently vague and subjective including:

- Failure by the taxpayer to provide information within the possession or control of the taxpayer *or its associated parties* [emphasis added] within a statutory timeframe;
 - Failure to respond to IR correspondence; the provision of misleading information (including where the information is misleading by omission);
 - Failure to provide sufficient information to determine the arm's length amount of a related party transaction, or to determine the amount of profit which should be attributable to a PE;
- 16 The NFTC believes the threshold at which a large multinational is treated as “non-cooperative” should be carefully considered by Inland Revenue which should consider the following when determining that a taxpayer is “non-cooperative”:
- Information requests by Inland Revenue can be onerous and sourcing the level of material can often be difficult to obtain from within large organisations within timeframes set by Inland Revenue. The NFTC notes that delays in obtaining relevant information are generally not driven by unwillingness of taxpayers to provide information, but are a product of practical difficulties of sourcing relevant information from within large organisations. Practical difficulties faced by large multinationals are similar (and probably more significant in comparison) to difficulties experienced by large New Zealand corporations. NFTC does not consider it appropriate or necessary to require a different standard of co-operation for large multinationals in comparison to large New Zealand corporate taxpayers.
 - Taxpayers that are required to provide a significant amount of information often treat the process of obtaining and providing information to Revenue Authorities as if it was part of the process of legal discovery to avoid costs involved in repeating the process if the matter progresses to litigation. This inevitably involves a more thorough process of data capture, compilation and review, with associated additional time and cost involved.

Payment of tax in dispute

- 17 The NFTC is concerned that payment of tax in disputes in advance of resolution may lead to inappropriate assessments, inappropriate incentives for Inland Revenue officials, and a substantial increase in tax risk and uncertainty which could chill foreign direct investment into New Zealand. Contrary to the assertion in paragraph 6.26 that the rule to impose early payment is intended to remove any incentive to prolong a dispute with Inland Revenue, the NFTC asserts that taxpayers favor early resolution of disputes. In any event, imposing interest on a final assessment, if any, fully compensates the government for the time before a final assessment is ascertained.

Collection of information

- 18 Paragraph 6.33 of the discussion document proposes that the Commissioner be provided with a direct power to request information or documents that are held by or accessible to a group member that is located outside New Zealand. The discussion document recognises that there have been recent improvements to the exchange of information between Revenue Authorities, making it easier for IR to obtain information. However, the discussion document states that in some cases the relevant information is not held by the offshore tax authorities and in other cases the foreign tax authority may be slow or unhelpful in responding to reasonable requests for information.
- 19 The NFTC notes that in addition to automatic exchange of information with other Revenue Authorities, the ability of Revenue Authorities to collect information from large multinationals has also increased as a result of the OECD country-by-country reporting initiative.
- 20 The NFTC believes that the proposal to introduce specific provisions to enable Inland Revenue to directly request information or documents from a group member that is located outside of New Zealand is unlikely to result in Inland Revenue receiving information in a timelier manner than it would if it were to request the same information from the New Zealand taxpayer under New Zealand's existing rules. Delays in responding to appropriate and relevant information requests from Inland Revenue are attributable to practical difficulties of sourcing appropriate and relevant information within large organisations, rather than because of unwillingness by large multinationals to provide relevant information.

Penalties for not providing information

- 21 Paragraph 6.35 of the discussion document proposes that a person may be convicted of an offence for failing to provide information held by an associated offshore group member.
- 22 The NFTC believes it would be inappropriate for New Zealand to expect officers and/or directors of the relevant New Zealand subsidiary to have access to offshore information, the ability to require offshore parent companies to provide information, or the ability to influence the production of non-New Zealand information appropriately or inappropriately requested by Inland Revenue. Exposing local officers and or directors to substantial penalties for failure to produce documents outside of their control is inappropriate and would materially impact the willingness of individuals to act as officers of New Zealand subsidiaries of multinational groups. The NFTC believes that it would not be reasonable or appropriate to impose penalties on New Zealand officers and/or directors for failing to provide information held by an associated offshore group member outside of their control.

The NFTC appreciates Inland Revenue's willingness to consider our comments and concerns. If you have any questions or comments regarding our submission, please feel free to contact me at 202 – 887-0278.

Sincerely,

A rectangular box containing a handwritten signature in black ink. The signature is written in a cursive style and reads "Catherine G. Schultz".

Catherine G. Schultz

Vice President for Tax Policy