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BEPS - Transfer pricing and PE avoidance
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
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Comments on BEPS - Transfer pricing and permanent establishment avoidance

Dear Deputy Commissioner, Policy and Strategy:

We represent the Digital Economy Group (the "DEG"), an informal coalition of leading U.S. and non-U.S. software, information / content, social networking, and e-commerce companies that provide goods or services through digital and non-digital means. A number of the members of the DEG have business activities in New Zealand. We are writing to provide the comments of the DEG on the proposal to deem a New Zealand PE of a nonresident enterprise if a related entity carries out sales-related activities for the nonresident in New Zealand (the "PE Anti-Avoidance Rule"), as set forth in the discussion document entitled, "BEPS - Transfer pricing and permanent establishment avoidance" (the "Discussion Document"). Although our comments principally address the PE Anti-Avoidance Rule, we also provide some brief comments on the Discussion Document's transfer pricing and administrative proposals.

We thank the New Zealand Inland Revenue (the "Inland Revenue") for the opportunity to provide comments on the Discussion Document. We applaud the Inland Revenue for following a transparent approach of soliciting and considering comments on the PE Anti-Avoidance Rule. This approach is particularly welcome in cases such as this, where the proposed changes to domestic legislation deviate from international norms. We also applaud the Inland Revenue for including in the Discussion Document detailed examples that allow interested parties such as the DEG to identify and address the exact causes of the Inland Revenue's concern with certain business structures.

Historically, New Zealand has been a firm advocate that the fundamental concepts of international tax law, such as nexus, source, character, and the application of the arm's length principle, should be developed and agreed on a consensus basis, and implemented consistently among trading partners. Even before the BEPS consensus is implemented, we are seeing a small number of jurisdictions choose the path of unilateral actions, creating a significant risk of serious fragmentation of the consensus-based international

tax framework, if other jurisdictions follow that path. Despite these recent examples, we respectfully suggest that New Zealand should maintain its historic position as an advocate for consensus-based rules and uniform implementation.

Accordingly, for the reasons we discuss in this submission, we respectfully recommend that the Inland Revenue either withdraw the PE Anti-Avoidance Rule or, in the alternative, defer consideration of the PE Anti-Avoidance Rule until the New Zealand authorities have had an opportunity to evaluate the impact of the BEPS Project recommendations on the common commercial structures that fall within the PE Anti-Avoidance Rule's scope. We respectfully request a meeting with representatives of the Inland Revenue and the New Zealand Treasury (and/or relevant Ministerial officials) to discuss further the points we raise in this submission.

Executive Summary

1. As requested in the Discussion Document, we provide a brief summary of our major points and recommendations in the order in which they appear in this submission.

    i. As proposed, the PE Anti-Avoidance Rule captures common commercial arrangements involving affiliated New Zealand entities that are not abusive. Transfer pricing adjustments, and not deemed PEs, are the appropriate response to any perceived undercompensation of the New Zealand sales support entity.

    ii. The PE Anti-Avoidance Rule creates almost a *per se* PE rule for many multinational groups that sell into New Zealand using a nonresident principal. Imposing direct tax on a nonresident on the grounds that a local affiliate performs *any* sales related activities would be a radical departure from the established norms for imposing direct tax on a nonresident and thus would constitute a "fundamental change[] to the current international tax framework."

    iii. We are not aware of any other jurisdiction, including Australia or the UK, that has adopted a rule similar in scope to the PE Anti-Avoidance Rule. The PE Anti-Avoidance Rule therefore represents the most extreme unilateral PE measure in the world.

    iv. The PE Anti-Avoidance Rule is inconsistent with the consensus approach of the OECD/G20 BEPS Project, which already has developed a consensus based recommendation for changes to the treaty law PE standard to address the in-market support structures on which the PE Anti-Avoidance Rule focuses. As the BEPS Project recommendations already are addressing the concerns the Discussion Document identifies, we believe that the more

appropriate course of action is to defer the consideration of the PE Anti-Avoidance Rule until the New Zealand authorities have had an opportunity to evaluate the impact of the BEPS Project recommendations on the structures that are within the PE Anti-Avoidance Rule's scope.

v. We endorse the proposal to adopt the revised OECD Transfer Pricing Guidelines ("TPG") and conform the New Zealand transfer pricing rules to the rules in the TPG. We respectfully recommend that New Zealand not adopt New Zealand-specific transfer pricing rules that deviate from the consensus interpretation of the TPG.

vi. If New Zealand shifts the burden of proof in transfer pricing cases from the Inland Revenue to the taxpayer, we respectfully recommend that the taxpayer only be required to prove that a result is within the range of reasonable results. We also respectfully recommend that the existing four-year statute of limitations for transfer pricing assessments be retained.

vii. We respectfully recommend that multinationals only be considered "noncooperative" from a tax administration standpoint where there is a willful, reckless, or negligent disregard of the requirement to timely produce truthful information in response to an Inland Revenue information request. We also respectfully recommend that New Zealand preserve the existing payment rule for amounts in controversy, and require taxpayers to pay the disputed tax only once the dispute is resolved. In addition, given the new country-by-country reporting and automatic exchange of information requirements, we believe that there is no need to expand the Inland Revenue's information-gathering powers in the manner described in the Discussion Document.

Centralized Sales Structures

2. We applaud the inclusion of examples in the Appendix to explain the Inland Revenue's concerns with centralized sales structures. As proposed, however, the PE Anti-Avoidance Rule will include in its scope common commercial structures that are not abusive.

3. In Example 1, a multinational group sells remotely into New Zealand without establishing any actual business presence in New Zealand. The PE Anti-Avoidance Rule does not apply in this case. In Example 4, the PE Anti-Avoidance Rule also does not apply where a multinational group sells into New Zealand using an affiliated New Zealand reseller. In an important comment, the Discussion Document notes that the proposed changes to New Zealand's transfer

pricing rules will allow New Zealand to "appropriately tax" this structure.

4. In contrast, Example 3 states that the PE Anti-Avoidance Rule applies to a multinational group that sells remotely to New Zealand customers because a New Zealand affiliate performs sales support activities. The inference from these examples is that combining the centralized sales model with some degree of local presence is abusive.

5. We respectfully submit that the basic fact patterns in both Examples 3 and 4 reflect extremely common business models that companies in a wide range of business sectors employ for sound commercial reasons. Some of the business reasons for choosing the centralized sales model include: (i) efficient cash management due to a single legal entity receiving all customer payments; (ii) simplified intercompany invoicing; (iii) simplified foreign exchange hedging at the principal company level for all receivables; (iv) consistent enforcement of group legal and financial business policies through centralized customer contract approvals; (v) application of single contract terms and choice of law in customer and supplier contracts; (vi) single legal entity identified as responsible party to pursue or defend IP enforcement claims; (vii) centralized compliance responsibility for regulatory requirements at a single entity; (viii) cost efficiencies arising from hiring personnel who can perform regional roles in a central location; and (ix) avoided costs of implementing financial accounting system support for multiple revenue points and intercompany sales transactions.

6. From a policy standpoint, it is difficult to justify treating the fact pattern in Example 3 as inherently more prone to abuse than the fact pattern in Example 1. If remote sales into New Zealand with no local presence are not abusive, adding local activities that are appropriately compensated for their role in creating value under the revised OECD TPG, as incorporated into New Zealand law, should not change that conclusion.

7. We suspect that the real concern about this structure is expressed in Example 3 itself as an assumed fact: that "the New Zealand subsidiary is a paid a fee for its services . . . [that] generally only exceeds its costs by a small margin." If that indeed is the actual concern, then the proper response is a transfer pricing adjustment, not a deemed PE of the nonresident. We see no reason why the revised TPG, with the recent enhancements expressly written to assure that transfer pricing outcomes are in line with value creation in exactly these cases, would not provide the Inland Revenue with the appropriate tools to "appropriately tax" this structure, just as the revised TPG provide such tools to "appropriately tax" the structure in Example 4.

8. The discussion in Example 3 notes the concern that a proper transfer pricing review of the value created by the local subsidiary would not be possible "as a practical matter (largely due to a lack of visibility over the value added through

the entire supply chain)."[1] We believe that these concerns based on lack of transparency will be directly addressed through country-by-country reporting and the enhanced transfer pricing reporting requirements imposed by Action 13.

9. We note that the Discussion Document in Example 4 expressly states that one of the problematic features of structures involving a New Zealand reseller is that principal companies in regional hub structures "typically carr[y] on limited actual activities in relation to" New Zealand sales.[2] As a broad generalization, this assumption is incorrect. In most cases, a company centralizes important functions in regional hubs to maximize both the commercial efficiencies of the centralized sales model described above and the company's ability to achieve market penetration across the region. Of relevance to the proposed PE Anti-Avoidance Rule, however, Example 4 shows that even under the assumption that the principal company carries on "limited actual activities" related to New Zealand sales, a proper application of the TPG will address any cases of undercompensation of the New Zealand in-market distributor. There is no more (or less) reason to assume that the business activities of a centralized sales entity which acts as principal for an in-market support structure conducts "limited actual activities" related to New Zealand sales. Accordingly, it is difficult to see how the tax policy responses to the cases of Examples 3 and 4 can be different.

10. We also believe that the TPG give the Inland Revenue the necessary tools to address third party channel provider arrangements, as set forth in paragraphs 3.27 - 3.28 of the Discussion Document. If transfer pricing adjustments are the appropriate response to perceived abuses in connection with sales into New Zealand through an affiliated New Zealand reseller, as Example 4 clearly states, transfer pricing adjustments, and not deemed PEs, also are the appropriate response to undercompensated New Zealand support affiliates in channel provider arrangements.

New PE Standard Under the PE Anti-Avoidance Rule

11. The Discussion Document states that the proposed rule "is not trying to widen the accepted international definition of a PE in substance."[3] With respect, the proposal does exactly that, as it creates almost a *per se* rule that applies to business structures that cannot be regarded as abusive, and proposes a PE threshold based on less economically significant activities than anything in current tax treaties or in the BEPS-recommended changes to Article 5.

12. Specifically, the rule applies if an arrangement satisfies the four criteria set forth in paragraph 3.21 of the Discussion Document. Of these four criteria, in practice

[1] Discussion Document, Example 3, p. 49.

[2] Discussion Document, Example 4, p. 50.

[3] Discussion Document ¶ 3.2.

only two will be operative terms, as the first and the third criteria are neutral facts - i.e., whether a nonresident supplies goods or services to a person in New Zealand and whether some or all of the sales income is not attributed to a New Zealand PE of the nonresident - which facts by themselves cannot indicate whether a structure is abusive, since they will exist in every case where goods or services are supplied into New Zealand without the involvement of an affiliate acting as a reseller of the goods or services. Therefore, the second and fourth criteria are the relevant subjects for discussion, as those two criteria represent the elements of the proposed standard which are meant to define an abusive structure.

13. Under the second criterion, the PE Anti-Avoidance rule may apply if a related entity "carries out an activity in New Zealand in connection with [a] particular sale for the purpose of bringing it about." This is a far lower threshold of economic activity for creating tax nexus of a nonresident than even the "principal role" standard that BEPS Action 7 recommends. The BEPS standard requires a local affiliate to play "the principal role" leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, a much more substantive activity than "an activity … for the purpose of bringing" about the sale. Under the proposed criterion, a New Zealand affiliate could give rise to tax nexus of a nonresident enterprise if it plays *any* role leading to the conclusion of a sales contract by the nonresident. Further, the requirement in the Action 7 recommendation that the contracts be concluded without material modification by the enterprise was intended to describe cases where there is no material business judgment exercised by the nonresident enterprise at the moment of contract conclusion. That point is absent from the proposed rule, so that a PE could arise even if personnel of the nonresident were heavily involved in contract negotiation and acceptance. Although the Discussion Document expressly excepts auxiliary or preparatory activities (such as advertising and marketing) from the list of tainted activities,[4] a wide range of activities that have never been considered to give rise to a deemed dependent agent PE, such as collaborative product design, routine sales promotion, solicitation, tech support, warranty repairs, etc., could conceivably fall within the scope of this criterion and trigger the application of the rule.

14. We believe that it is difficult as a policy matter to justify imposing tax nexus on a nonresident enterprise based on such limited local activities performed by an affiliate which is appropriately compensated under the arm's length principle. The objective of the PE standard is to assess when a nonresident enterprise itself conducts sufficient business activity through its actual presence in a state to warrant direct taxation of the nonresident. In considering whether a nonresident should be subject to local tax by virtue of attribution theories based on a dependent agent or similar activity, that policy choice should take into account

[4] Discussion Document ¶ 3.22.

the fact that the local affiliate is fully taxable in that state.

15. Thus, a nonresident without premises at its disposal in a state should be subject to direct tax in that state only if the nonresident itself could be said to be in fact conducting its business in that state - i.e., concluding contracts - on a regular basis through a local person operating in that state. The "principal role" standard lowers the threshold for tax nexus but still is faithful to the premise that the dependent person must be performing those activities in the state which lead immediately to contract conclusion, without material involvement at that moment by the nonresident, before the nonresident may be subject to direct taxation in that state by virtue of the attributed activities.

16. Imposing direct tax on a nonresident on the grounds that a local affiliate performs *any* sales related activities would therefore be a radical departure from the established norms for imposing direct tax on a nonresident. It is difficult to reconcile this feature of the PE Anti-Avoidance Rule with the statement in the Discussion Draft that the proposed measures "are not intended to make any fundamental changes to the current international tax framework."[5]

17. Under the fourth criterion, the PE Anti-Avoidance Rule applies where an "arrangement defeats the purpose of [the relevant tax treaty's] PE provisions." Nothing in the hypothetical case of a nonresident enterprise selling remotely into New Zealand with the assistance of a local sales support affiliate defeats the "purpose" of the PE standard, which is to define when the actual commercial facts indicate that the nonresident seller itself has sufficient actual presence in a state to justify the state's imposition of direct tax on the nonresident. Thus, unless a particular arrangement has some unique hallmarks of treaty abuse, nothing in what is otherwise a common commercial arrangement in itself should be considered to defeat the "purpose" of the treaty.

18. The Discussion Document states that the objective of the fourth criterion is to assess whether supplies are made "through a PE in substance."[6] The Discussion Document then proposes five factors to use in determining whether this test is met. The first three factors (the commercial and economic reality of the arrangement, the relationship between the nonresident and the related entity in New Zealand, and the nature of the services carried out by the related entity) are exceedingly vague, and provide no particular guidance as to whether the nonresident has the requisite degree of physical or other business presence in New Zealand.

19. The fifth factor seems to be the key to the proposal, as that factor purports to list indicators of PE avoidance, which indeed is the policy focus of the proposal. It is

[5] Discussion Document ¶ 1.4.

[6] Discussion Document ¶ 3.24.

hard to see, however, that the proposed indicators (i.e., whether the arrangement involves 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) actually point towards abusive structures.[7] Whether a principal company has a tax rate that is lower than the New Zealand rate has no relationship to whether activities actually conducted in New Zealand directly by or on behalf of a nonresident rise to a level that could justify imposing direct tax on the nonresident. This element of the proposal suggests that New Zealand intends to apply different PE standards to different trading partners based on whether a partner has a tax rate that is acceptably high from a New Zealand perspective. Whether the New Zealand affiliate performs "specialised" services and the amount of profit allocated to the New Zealand affiliate based on that entity's functions, assets and risks also are not relevant to whether the nonresident itself has the requisite degree of actual business presence in New Zealand to warrant direct taxation. Rather, these issues relate to whether the pricing of the relevant intercompany arrangements complies with the arm's length principle.

20. Only the fourth factor is relevant to whether a nonresident could be said to have the requisite physical presence in New Zealand, but this factor is the most radical feature of the proposal. The fourth factor allows the Inland Revenue to test whether a nonresident enterprise would have had a New Zealand PE but for the separate legal existence of the nonresident and a New Zealand affiliate. This factor is contrary to New Zealand's treaties, which include an article based on Article 5(7) of the OECD Model, as explained in paragraph 40 of the Article 5 Commentary: "It is generally accepted that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, *such a subsidiary company constitutes an independent legal entity*." (emphasis added)

21. The practical consequence of this factor would be to create a New Zealand PE of a nonresident in every case in which the activity of the New Zealand affiliate is not preparatory or auxiliary, as the premises and personnel of the affiliate would be attributed to the nonresident. This factor therefore would create an almost *per se* PE rule for multinational groups with New Zealand sales support affiliates.

22. We are not aware of any other jurisdiction that has adopted a rule that eliminates the distinction between separate legal entities for the purpose of asserting a PE. This rule effectively imposes PE reporting obligations on all groups which sell remotely into New Zealand using a local affiliate. This element does not exist in other anti-avoidance rules, such as the Australian Multinational Anti-Avoidance

[7] We assume that the last two criteria refer to attributes of the New Zealand affiliate, but there is no indication in the text as to which entity is being referenced.

Law ("MAAL") or the UK Diverted Profits Tax ("DPT"). Accordingly, as proposed, the PE Anti-Avoidance Rule represents the most extreme unilateral PE measure in the world. We believe that such a rule would not be consistent with the historic policy and practice of New Zealand.

23. We also struggle to see the potential PE abuse in channel provider arrangements. As the Discussion Document acknowledges, multinational groups use channel provider arrangements for "good commercial reasons."[8] There is no doubt that the channel provider (a New Zealand taxpayer) is compensated at arm's length for its services because it is unrelated to the nonresident. In addition, since the channel provider has taken over some or all of the sales responsibilities, the logical inference is that there is less reason for PE concern than in a pure related party arrangement on the grounds that the New Zealand affiliate is less likely to play "the principal role" leading to the conclusion of the contract with the New Zealand customer. The Discussion Document nevertheless justifies a finding of a PE on the grounds that the nonresident and the channel provider are "working together" to sell to the New Zealand customer, and that the New Zealand affiliate therefore assists the nonresident by assisting the channel provider.

24. The Discussion Document does not provide any detail on the level of activity that could give rise to a PE in connection with a channel provider arrangement, leading to the conclusion that a local affiliate merely "working together" with the channel provider to pursue a sale could give rise to a PE. That standard would be remarkably low and ambiguous (e.g., would merely accompanying a channel provider to a customer site trigger the application of the rule?). That standard also would discourage nonresidents from engaging unrelated New Zealand channel providers to support New Zealand customers since such arrangements now would give rise to PE uncertainty in addition to requiring the nonresident to compensate both the channel provider and address the PE exposure arising due to the affiliate's activities.

25. We fully acknowledge that any tax administration must possess tools to properly address true cases of treaty abuse. The Discussion Document indicates that one such case is that in which a multinational group takes the position that a New Zealand affiliate performs only general support activities (e.g., marketing), but, in substance, the affiliate negotiates and concludes contracts on behalf of a nonresident.[9] As the Discussion Document appears to acknowledge, New Zealand's existing domestic and treaty law rules provide tools, including anti-abuse rules, that allow the Inland Revenue to address these arrangements. The fact that employing these tools may require resource intensive audits is not a sufficient justification for the radical legal change that the Discussion Document

[8] Discussion Document ¶ 3.29.

[9] *See* Discussion Document ¶ 3.13.

proposes. Furthermore, the introduction of the information gathering, transparency and cooperation measures the Discussion Document proposes will ultimately ease the Inland Revenue's administrative burden on audit, thereby reducing further the need for an unfocused rule of convenience like the PE Anti-Avoidance Rule.[10]

Profit Attribution Under the PE Anti-Avoidance Rule

26. The Discussion Document states that the Inland Revenue expects "a fairly significant amount of . . . sales income [to be] attributable to the deemed PE" under the PE Anti-Avoidance Rule.[11] We believe that this assumption is not likely to be correct in reality. Specifically, it is difficult to envision what additional profits could be attributed to a deemed PE with respect to in country sales activities where those activities already have been fully rewarded under the revised OECD TPG, as implemented in New Zealand law. The Discussion Document correctly acknowledges that income attributable to the nonresident's offshore activities will not be subject to direct tax in New Zealand.[12] Since in general all value other than value arising from the sales functions performed by the affiliate will have been created outside of New Zealand, the profit attribution result under the PE Anti-Avoidance Rule is likely to be zero in most, if not all, cases.

27. This result is even more likely for a deemed PE created under the proposed PE Anti-Avoidance Rule than is the case for deemed PEs arising under the current Article 5(5) or the BEPS Action 7 "the principal role" test, since the activities which give rise to a deemed PE under the PE Anti-Avoidance Rule almost invariably will create less value through the in-country functions, and involve the use of fewer assets, than deemed PEs arising under the other two rules.

The BEPS Project Addresses These Issues Through an International Consensus

28. The OECD/G20 BEPS Project constitutes "the most fundamental changes to international tax rules in almost a century."[13] From the beginning, the expressed goal of the BEPS Project has been to create a consensus set of revised international tax rules, and implement them consistently around the world.[14] The

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[10] *See* Discussion Document, Ch. 6.

[11] Discussion Document ¶ 3.36.

[12] Discussion Document ¶ 3.8.

[13] Statement of OECD Secretary-General, Angel Gurría, May 10, 2015, *available at* http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm.

[14] *See* Action Plan on Base Erosion and Profit Shifting at 13 (2013) ("This Action Plan calls for . . . the adoption of new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting."); Pascal Saint-Amans - The Face of BEPS, Tax Analysts, Dec. 22,

proposed PE Anti-Avoidance Rule clearly is a statement by New Zealand that it is prepared to follow the route of unilateral actions and depart from the consensus positions. With respect, we believe that decision would be shortsighted.

29. We note that many of the "in-market support structure" cases identified as "problematic" would be addressed directly by the new "the principal role" standard (and even by the current Article 5(5) standard in cases of actual abuse). The OECD/G20 consensus recommendation to change the OECD Model PE standard already has had an impact on company structures, even though the treaty ratification process has not yet been completed. Many multinational groups, including significant participants in the digital economy, have begun the process of reorganizing their commercial structures. These have included reorganizations of in-country sales and purchasing functions into resellers in multiple sales jurisdictions. Despite the commercial efficiencies of centralized sales structures noted above, groups are taking their lead from this new international tax consensus to reorganize their commercial structures in the direction encouraged by the BEPS Project.

30. Through the OECD/G20 transparency initiatives, including country-by-country reporting, these structural changes will become apparent in the coming years. These changes may not yet be visible to tax administrations which develop information through audit procedures, as those procedures necessarily focus on past years.

31. Accordingly, we believe that the ongoing implementation of the BEPS Project will address exactly the concerns identified in Examples 3 and 4 of the Discussion Document. We respectfully suggest that the more appropriate course of action at this point is to defer the consideration of the PE Anti-Avoidance Rule until the New Zealand authorities have had an opportunity to evaluate the impact of the BEPS Project recommendations on the structures that are within the PE Anti-Avoidance Rule's scope.

32. We note that the Discussion Document mentions that some of New Zealand's treaty partners may not adopt the BEPS Action 7 recommendations, which the Discussion Draft asserts justifies a unilateral approach for New Zealand.[15] These passages transparently communicate that New Zealand is prepared to substitute a unilateral New Zealand standard for the OECD/G20 consensus, including in trading relationships where New Zealand's treaty partner chooses not to adopt the Action 7 recommendation. Essentially, New Zealand is challenging the OECD/G20 view that countries may choose whether or not to adopt the

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2014, ("A major reason for the project's two-year timeline, Saint-Amans said, is that the OECD had to move quickly to keep consensus among all countries and to prevent them from acting unilaterally to tackle sources of BEPS.").

[15] Discussion Document ¶ 2.9.

"principal role" rule in their treaties. In contrast with the four minimum standards to which all participants in the BEPS Project committed, participants are free to choose whether to incorporate the BEPS Action 7 recommendations in their treaties. New Zealand essentially is saying that New Zealand treaty partners do not have that choice.[16]

33. We observe that this approach is unusual for New Zealand, which has been a conscientious participant in the BEPS Project. This approach also is inconsistent with New Zealand's historic active role in helping to develop an OECD consensus to be applied on a consistent basis. In addition, the rule is ultimately inconsistent with the core treaty policy of establishing a framework for taxing nonresidents to which treaty partners bilaterally agree.

34. We note that some countries may be choosing to not adopt the Action 7 recommendations broadly through the Multilateral Instrument in order that they may choose selectively which treaty partners to approach with a view towards negotiating appropriate treaty changes on a bilateral basis. The Inland Revenue might consider this approach as a more targeted response to the perceived issues.

35. We respectfully suggest that unilateral actions intended to bypass the OECD/G20 consensus recommendations will not be healthy in the long run for New Zealand. If New Zealand adopts this rule, other jurisdictions may well reference the PE Anti-Avoidance Rule as a justification for adopting their own radical, nonconsensus positions. These positions ultimately will impact New Zealand enterprises engaging in cross-border trade, creating greater possibilities of double taxation and enhanced disputes on cross-border transactions.

Interaction with Treaty Network

36. We note the statement that the PE Anti-Avoidance Rule would apply "notwithstanding anything in a DTA."[17] We assume that this statement signals that the rule would be legislated in the same way as the current General Anti-Avoidance Rule ("GAAR"), ostensibly allowing enforcement of the rule outside the scope of New Zealand's tax treaties. We also note that the Discussion Document points to the UK DPT and the Australian DPT as prior examples of this approach.[18] We note, however, that a principal element of the justification that those taxes can be imposed outside the scope of tax treaties already in force

[16] We note that paragraph 2.9 of the Discussion Document suggests that additional measures to counter PE and transfer pricing avoidance are necessary as several trading partners will not adopt the BEPS treaty measures. We note that the revisions to the TPG are effective regardless of any adoption of the Action 7 proposals, so decisions by a country whether to adopt the Action 7 proposals will have no effect on the ability of New Zealand to apply the revised TPG, as incorporated into New Zealand law.

[17] Discussion Document ¶ 3.45.

[18] Discussion Document ¶¶ 2.15; 3.34.

is the assertion that the DPTs are not taxes on income or capital that are covered by Article 2.[19] While that view is subject to considerable doubt, since both DPTs in fact impose tax by reference to the profits of the enterprise, it is important to note that this justification cannot apply to support a treaty override under the New Zealand proposal. The PE Anti-Avoidance Rule sets a different definition of which nonresident enterprises are subject to the New Zealand corporate tax, but the tax that is imposed is indeed the same tax of general applicability imposed on all corporations. Thus, we believe that the PE Anti-Avoidance Rule conflicts with New Zealand's treaties, and any override based on GAAR-type principles could apply only in the case of actual abuse of the treaty.

37. In essence, the proposal constitutes a unilateral, selective rewriting of the PE Article for certain of New Zealand's treaty partners. We respectfully suggest that changes of that sort are best left to bilateral negotiations.

Substantive Transfer Pricing Rules

38. The Discussion Document characterizes transfer pricing as a "strategy" that multinational groups can use to shift profits out of New Zealand.[20] Transfer pricing is not a "strategy." Transfer pricing simply is the implementation of the legal requirement that associated enterprises conduct their affairs at arm's length. Since the arm's length principle applies to all cross-border transactions, transfer pricing rules must focus on providing clear guidance to taxpayers and tax administrations alike.

39. With that objective in mind, we endorse the proposal to adopt the revised OECD TPG and conform the New Zealand transfer pricing rules to the rules in the TPG. The TPG have proven to be a useful expression of international consensus. To preserve the benefit of this consensus, we respectfully recommend that New Zealand not adopt New Zealand-specific transfer pricing rules that deviate from the consensus interpretation of the TPG. One clear example of such a deviation is the Australian non-recognition / reconstruction rules. These rules are unique to Australia, are inconsistent with the rules in the TPG, and would make New Zealand an outlier from a transfer pricing standpoint if they were to be incorporated into New Zealand law.[21]

40. Every cross-border transaction involves another jurisdiction. Thus, every New Zealand specific transfer pricing rule or interpretation is likely to result in an increase in transfer pricing controversies. Such controversies will result in a

[19] Discussion Document ¶ 2.11 ("The DPTs that have been proposed in Australia and enacted in the UK tax the diverted profits of large multinationals. Their DPTs are an anti-avoidance measure and are entirely separate taxes levied at a penal rate compared with income tax.").

[20] Discussion Document ¶ 5.7.

[21] *See* Discussion Document ¶¶ 5.34 - 5.40.

burden on cross-border trade, to the detriment of New Zealand residents.

Procedural Transfer Pricing Rules

41. The Discussion Document proposes to shift the burden of proof in transfer pricing cases from the Inland Revenue to the taxpayer.[22] In many cases, the relevant comparability analysis will produce a range of results, all of which could be arm's length.[23] Accordingly, we respectfully recommend that the principle be clear that the taxpayer only needs to prove that a result is within the range of reasonable results. An alternative approach, in which the taxpayer must prove that the specific result within that range is correct, is unworkable. Under that latter approach, taxpayers could never have certainty that their transfer pricing would be accepted since the Inland Revenue always could propose a different result within the arm's length range.

42. The Discussion Document also proposes to extend the "time bar" for transfer pricing assessments from four years after the end of the year in which a company provides the relevant return to the Inland Revenue to seven years after that date.[24] The Discussion Document justifies this proposal on the grounds that the non-arm's length nature of certain transfer pricing arrangements only becomes apparent after a longer period of time.[25] We respectfully recommend that the existing statute of limitations on transfer pricing assessments be retained. If, as the Discussion Document proposes, the burden of proving that a transaction is arm's length shifts to the taxpayer, a longer time bar is not necessary, since the taxpayer must affirmatively demonstrate, using the information at its disposal, including financial projections, the arm's length nature of an arrangement. In this case, the Inland Revenue has the opportunity to assess whether or not an arrangement will give rise to an arm's length result even for periods outside the assessment period.

43. In addition, extending the time bar for transfer pricing assessments, but not for other tax items, such as income tax, withholding tax, and indirect tax, could further complicate the audit process, because transfer pricing and other tax items often are interrelated.

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[22] Discussion Document ¶ 5.47.

[23] *See* OECD Transfer Pricing Guidelines, Ch. III ¶ 3.55 ("In some cases, it will be possible to apply the arm's length principle to arrive at a single figure (*e.g.* price or margin) that is the most reliable to establish whether the conditions of a transaction are arm's length. However, because transfer pricing is not an exact science, there will also be many occasions when the most appropriate method or methods produces a range of figures all of which are relatively equally reliable.").

[24] *See* Discussion Document ¶¶ 5.67 - 5.72.

[25] Discussion Document ¶ 5.68.

Administrative Measures

44. The Discussion Document proposes to introduce new administrative measures to apply to multinational groups that are "noncooperative" with the Inland Revenue.[26] As a threshold matter, we note that many of the actions that the Discussion Document characterizes as "noncooperative," such as a "[f]ailure to comply within a statutory time-frame with Inland Revenue's reasonable requests" and a "failure to respond to Inland Revenue correspondence,"[27] may in fact reflect events that are beyond the taxpayer's control. Based on our members' experience, it is often difficult and time-consuming to procure the information that the Inland Revenue requests because of the large size of a multinational enterprise and the significant scope of the enterprise's activities. In addition, where the Inland Revenue requests a large volume of information, the enterprise may wish to obtain and provide information to a standard that is sufficient for the legal discovery process so as to avoid duplicating the effort a second time should an inquiry progress to litigation and, if necessary, seek the Inland Revenue's agreement to this.

45. Thus, based on our members' experience, the perceived delay in providing information requested to the Inland Revenue within the Inland Revenue's desired timeframe is generally attributable to the amount of time it takes any large enterprise to source information from within the organization. This delay is not attributable to any unwillingness to provide the information timely on the part of the taxpayer; rather, it typically is due to the constraints on those internal resources required to respond to large information requests received from multiple jurisdictions. Accordingly, we respectfully recommend that the Inland Revenue limit those actions that constitute evidence of "noncooperation" to actions that represent a willful, reckless, or negligent disregard of the requirement to timely produce truthful information in response to an Inland Revenue information request.

46. The Discussion Document proposes to require nonresident enterprises to pay tax that is the subject of a dispute before the dispute is resolved.[28] We respectfully recommend that New Zealand preserve the existing payment rule for amounts in controversy, and require taxpayers to pay the disputed tax only once the dispute is resolved.

47. Late payment interest fully compensates the New Zealand Treasury for any tax that is paid after the year to which the tax relates. Demanding payment of tax before a dispute has been resolved has been used in other jurisdictions as leverage

[26] Discussion Document ¶ 6.13.

[27] Discussion Document ¶ 6.16.

[28] *See* Discussion Document ¶¶ 6.21 - 6.26.

to compel nonresident taxpayers to settle disputes due to lack of confidence in that jurisdiction's judicial and administrative review and refund procedures. We respectfully submit that New Zealand need not align itself with such a heavy handed approach to tax compliance.

48. The Discussion Document proposes to allow the Inland Revenue to request information from the group's New Zealand affiliate regarding non-New Zealand group members.[29] The Discussion Document further proposes to change the New Zealand criminal rules to allow a person to be convicted of a criminal offense if that person fails to provide information in response to such a request.[30] In addition, the Discussion Document proposes to allow the Inland Revenue to deem income attributable to a New Zealand affiliate or PE of a multinational group if the group fails to provide information in response to such a request.[31]

49. We believe that the proposed expansion of the Inland Revenue's information-gathering powers is unnecessary. The new country-by-country reporting and automatic exchange of information requirements, once fully implemented across the world, will provide the Inland Revenue with effective tools to obtain information regarding nonresident enterprises.

* * *

For the reasons noted above, we respectfully recommend that the Inland Revenue withdraw the PE Anti-Avoidance Rule and address perceived abuses under New Zealand's existing domestic and treaty law rules. In the alternative, we respectfully recommend that the Inland Revenue defer consideration of the PE Anti-Avoidance Rule until the New Zealand authorities have had an opportunity to evaluate the impact of the OECD/G20 BEPS Project recommendations on the common commercial structures that fall within the PE Anti-Avoidance Rule's scope. We also respectfully recommend that the Inland Revenue revise the Discussion Document's transfer pricing and administrative proposals in the manner described above.

We thank the Inland Revenue for the opportunity to provide our comments on the Discussion Document. We would welcome the opportunity to meet with the Inland Revenue to discuss our recommendations and are prepared to provide additional input as needed.

Yours sincerely,

[29] Discussion Document ¶ 6.33.

[30] Discussion Document ¶ 6.35.

[31] Discussion Document ¶ 6.37.

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