

28 April 2017

BEPS – Transfer pricing and permanent establishment avoidance C-/ Cath Atkins Deputy Commissioner, Policy and Strategy Inland Revenue Department PO Box 2198 WELLINGTON 6140

Dear Cath

## **BEPS - TRANSFER PRICING AND PERMANENT ESTABLISHMENT AVOIDANCE**

The Corporate Taxpayers Group ("the Group") is writing to submit on the Government Discussion Document "BEPS – Transfer pricing and permanent establishment avoidance" (the "discussion document"). The Group is appreciative of the opportunity to submit on this discussion document and looks forward to discussing the proposals further with officials. The Group appreciates having had the opportunity to talk to Officials¹ about the discussion document and those discussions have informed some of the comments in this submission.

We provide a summary of our submission below. Further detail is included in the attached appendices:

- Appendix One: General comments
- Appendix Two: Permanent establishment avoidance
- Appendix Three: Amendments to the source rules
- Appendix Four: Transfer pricing rules
- Appendix Five: Administrative measures

## **Summary of our submission**

The key points in our submission are:

## General comments

- The Group is very concerned that the compressed timeframe for consultation on these issues has not allowed the private sector and other stakeholders of the tax system adequate time to fully work through the issues which may arise from these proposals.
- The Group does not support proposals which deviate from what the OECD has recommended. These proposals will result in double taxation and remove taxpayers' rights under double tax agreements.

#### **Contact the CTG:**

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We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

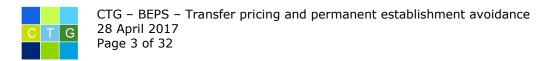
<sup>&</sup>lt;sup>1</sup> Workshop with Sam Rowe, Gordon Witte, Steve Mack and Matt Cowen on 13 April 2017.



- In the Group's view, many of the proposed changes negatively impact on the attractiveness of New Zealand as an investment destination. New Zealand's tax system plays a critical role in our competitive position with our major trading partners and competitors. At our workshop, Officials acknowledged that these proposals are in substance a Multinational Anti-avoidance Law ("MAAL") and they have many features of a Diverted Profits Tax (DPT).
- As inferred in paragraph 2.22 of the discussion document, many of the proposals in the document do not alter the outcomes under the existing law, should Inland Revenue use the full suite of tools currently available to it. The effect of these proposals is to potentially reduce compliance costs for Inland Revenue in enforcing the law against a very small number of taxpayers, but to significantly increase them for all taxpayers operating cross-border. Therefore the Group questions whether the changes are warranted, particularly given the negative impact that the perception of these changes may have on investment in New Zealand.
- The Group notes that if the rules governing New Zealand's tax system become too complex for foreign companies, they will no longer sell into New Zealand or may fundamentally change the way they sell into New Zealand, resulting in a loss of economic activity in relation to support functions.
- The Group appreciates that the Inland Revenue may find auditing multinational organisations "resource intensive" (as noted in paragraph 3.13), however this does not justify imposing large compliance costs on all compliant taxpayers.
- The Group considers that overall these proposals will be detrimental to tax certainty for taxpayers.
- The Group does not support the proposed application dates. Any changes implemented need to be complemented by appropriate grandparenting provisions for existing arrangements. Taxpayers need to be allowed a reasonable amount of time to undertake any necessary restructuring.

# Permanent establishment ("PE") avoidance

- In the Group's view, departing from such core principles risks New Zealand falling out of step with the rest of the world, and in turn risking retaliatory action in jurisdictions in which we operate. New Zealand's best chance of ensuring that its exports are not overtaxed is to ensure that it does not act unilaterally and seek to assert taxing rights over revenue where the income earning activity (including IP) is located outside of New Zealand.
- The importance of DTAs cannot be understated: they exist to facilitate international trade. Having concluded a DTA with a foreign jurisdiction, New Zealand needs to be very cautious in implementing domestic legislation that has the effect of undermining the deal struck in a DTA. Such action risks not only undermining New Zealand's international reputation but also risks foreign jurisdictions taking retaliatory action against New Zealand companies operating "in" their jurisdiction.
- In our workshop we provided an example of a Group member with two employees in Japan. These employees are Japanese natives as it is necessary to have people on the ground who speak the language and understand the customs under which its customers operate. These employees talk to customers and translate communications back into orders that the Group member acts upon. In no way do the two Japanese employees have any role in concluding contracts or fulfilling orders. In the Group's view this type



of example should not give rise to a PE in Japan and cause allocation of profits to be taxed in Japan. However, in our workshop it was concluded by Officials that this was an example that was "close to the line" if the New Zealand proposals were to be applied to the arrangement.

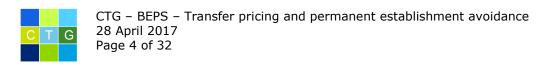
- The Group submits that there are valid reasons why multinationals may conclude contracts outside of New Zealand. This is not necessarily about PE avoidance, but relates to the size and importance of New Zealand operations relative to the rest of the multinational organisation. New Zealand has a very small domestic economy, geographically remote from the rest of the world, and the activities undertaken in country reflect this. For example, in many instances it does not make sense for the multinational to have a legal team based in New Zealand. Linked to the point above, just because an individual in New Zealand is "well paid" does not mean that they are able to conclude contracts.
- A natural consequence of the introduction of these rules could be for non-residents to stop hiring any staff in New Zealand.

It is critical that, if these proposals proceed, Inland Revenue should provide clear commentary for taxpayers on how it considers profits should be attributed to PEs. The rules cannot act as a "force of attraction" principle and seek to bring into the New Zealand tax base all New Zealand sales revenues simply because some functions are carried on in New Zealand. Any attribution of profit to New Zealand must reflect the actual degree of activity and effort in New Zealand – value added outside of New Zealand cannot be taxed in New Zealand.

- The Group submits that it should be clarified what the "purpose of the DTA's PE provisions" is in relation to the deeming of a PE in New Zealand (as per paragraphs 3.21 and 3.27). In the Group's view, whether an organisation has a PE or not, is an 'in or out' test an organisation either has enough of a presence in New Zealand or not. The Group queries whether an organisation that is close to having a PE but does not have quite enough 'presence' could be considered to have defeated the purpose of the provisions.
- The Group notes that there are PE rules in DTAs and then there are the PE rules in the OECD Action 5 material. In the Group's view, the proposed rules in this discussion document are unnecessary, add complexity to the rules and disregard the purpose of DTAs.
- The rules proposed in paragraphs 3.21 and 3.27 both contain a criterion that "the arrangement defeats the purpose of the PE provisions". The Group submits that any such criteria should refer to the dominant purpose of the arrangement.
- This proposal should not have the effect of overriding New Zealand's DTAs. It is important that taxpayers continue to have access to MAP and arbitration procedures guaranteed in New Zealand's network of treaties.

#### Amendments to the source rules

• In the Group's view, the proposed changes to the source rules are unnecessary as the current source rules are sufficiently broad to capture any situations the Commissioner is concerned with.

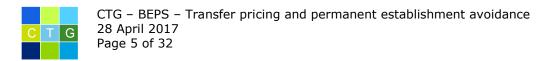


# Strengthening the transfer pricing rules

- Overall the Group does not believe that further strengthening of the transfer pricing rules are required. Inland Revenue already has a number of tools available to it and these tools should be applied.
- The Group does not support the extension of the time bar for transfer pricing positions to seven years. In the Group's view, this goes against Inland Revenue's Business Transformation principles and incentivises bad behaviour by Inland Revenue to not close out matters in a timely manner. In the Group's view, an adequately resourced Revenue should be able to complete this process within four years. The Group notes that there are significant costs involved in a transfer pricing dispute and extending the time bar to seven years will only increase these costs.
- The Group does not support shifting the burden of proof from the Commissioner to the taxpayer. However, if the onus does shift then it is important that the information required to prove that a particular transaction is arm's length must be limited to publicly available information / comparables. If the Commissioner seeks to rely on "secret information", then that information must be disclosed; and if such information cannot be disclosed with breaching confidentiality, then it is not appropriate that the Commissioner have regard to that information.
- The Group submits that there needs to be sufficient controls put in place when the Commissioner wishes to reconstruct a related party transaction. The Group notes that this power is essentially the Commissioner telling a company how to run its business and this kind of decision should only be made in exceptional circumstances. In the Group's view it must be clearly defined what activities / transactions are 'aggressive' and 'commercially irrational' there needs to be structure and transparency around who decides this. Any powers of reconstruction need to be limited to only the most extreme circumstances and should only be assessed at the highest levels within Inland Revenue.
- The Group foresees difficulty in applying transfer pricing rules to investors acting in concert. The mere fact that there are unassociated parties coming together indicates there should already be arm's length pricing in place; i.e. there is natural tension to ensure each party is not receiving more than their fair share.
- It is important that Inland Revenue is appropriately resourced with skilled transfer
  pricing resource so that reviews can be completed efficiently (within four years) and
  the disputes process can run as intended i.e. there are independent and impartial
  transfer pricing experts available to participate in taxpayer conferences and
  adjudication. There also needs to be sufficient resourcing to allow for an increase in the
  volume of APAs that will likely be sought if these proposals are enacted.

#### Administration measures

• There will need to be clear guidelines as to when a taxpayer may be deemed to be non-cooperative. In particular: (i) "non-cooperative" should have a legislated definition and that definition should confirm that a taxpayer is not considered non-cooperative merely because the taxpayer exercises its rights to dispute Inland Revenue's position or contest any steps Inland Revenue may take in an investigation; (ii) there should, in addition, be guidelines issued in the form of a Standard Practice Statement. These guidelines should record the process for determining whether a taxpayer is non-cooperative. In the Group's view this power should rest with a select few senior officials



within Inland Revenue. These officials should be independent from the officials auditing or otherwise engaged with the taxpayer.

- The Group submits that a taxpayer should have the right to apply to the High Court to challenge any decision of Inland Revenue to deem the taxpayer non-cooperative. Given the reputational damage and other consequences that could result from being deemed "non-cooperative" it is important that taxpayers have a means of challenging such a determination.
- The Group does not support the proposal to require taxpayers to pay the tax earlier in the disputes process. The general rule that disputed tax be payable only following final determination of any dispute should remain, except in cases where there is a risk of non-payment of tax found owing (in which case Inland Revenue already has power (see section 138I of the Tax Administration Act ("TAA")) to require early payment). Further, taxpayers are not incentivised to delay resolution of disputes (as suggested by the Discussion Document) given the imposition of use of money interest at rates considerably higher than commercial rates.
- The Group does not support the restriction on the use of tax pooling for disputes involving transfer pricing, the application of the source rules or tax payable under a DTA.
- The Group does not support the proposal to introduce a new statutory power to collect tax from wholly owned subsidiaries of multinationals in New Zealand. This is an unnecessary legislative amendment which may cause significant issues for New Zealand taxpayers in assessing their liabilities (in relation to lending covenants, the solvency test etc.). Inland Revenue already has powers to request assistance in the collection of tax under the *Convention on Mutual Administrative Assistance in Tax Matters*, therefore this rule is unnecessary. If the proposed rule were to proceed, Inland Revenue should be required to obtain a court order to impose on the New Zealand company liability for taxes owing by a different legal entity. The proposed rule is a major departure from the usual corporate law principle of limited liability and so requires judicial oversight in its application.
- The Group does not support a power for Inland Revenue to make a New Zealand entity legally responsible for providing information Inland Revenue may believe is held by another member of the multinational group. It is inappropriate for a New Zealand company to be subjected to monetary penalties and potentially criminal liability for failure to provide information over which that person has no control. If the proposed rule were to proceed, Inland Revenue should be required to obtain a court order to impose on the New Zealand entity or person liability for non-provision of such information. This would provide judicial oversight in respect of the breadth of the request and feasibility of complying with it, and as to whether the need for such an onerous power to be exercised is justified in the circumstances.
- The Group submits that it is not appropriate for Inland Revenue to have the power to impose a \$100,000 penalty on taxpayers who fail to comply with section 17 or 21 of the TAA. Such a power should be left to the courts. This is especially so when taxpayers could be subject to penalties when information is not provided by a member of its multinational group and may have no control over whether the member provides the information or not.
- Section 21 in any event needs to be rewritten. It is arbitrary in its application (e.g. it is triggered by the non-response to an information request after 90 days without regard to whether that time-frame is reasonable in the circumstances, and is disproportionate

in its consequences (in denying a taxpayer access to the courts to contest the correctness of Inland Revenue's assessment)).

Any changes implemented need to be complemented by appropriate grandparenting
provisions for existing arrangements. Taxpayers need to be allowed a reasonable
amount of time to undertake any necessary restructuring. At the very least the
proposals, to the extent that they proceed, should only apply in respect of income years
for which a tax position is taken after date of enactment.

We look forward to discussing this submission further with you.

For your information, the members of the Corporate Taxpayers Group are:

1.	Air New Zealand Limited	21.	New Zealand Racing Board
2.	Airways Corporation of New Zealand	22.	New Zealand Steel Limited
3.	AMP Life Limited	23.	New Zealand Superannuation Fund
4.	ANZ Bank New Zealand	24.	Opus International Consultants Limited
5.	ASB Bank Limited	25.	Origin Energy New Zealand Limited
6.	Auckland International Airport Limited	26.	Pacific Aluminium (New Zealand) Limited
7.	Bank of New Zealand	27.	Powerco Limited
8.	Chorus Limited	28.	Shell New Zealand (2011) Limited
9.	Contact Energy Limited	29.	SKYCITY Entertainment Group Limited
10.	Downer New Zealand Limited	30.	Sky Network Television Limited
11.	Fisher & Paykel Healthcare Limited	31.	Spark New Zealand Limited
12.	Fletcher Building Limited	32.	Summerset Group Holdings Limited
13.	Fonterra Cooperative Group Limited	33.	Suncorp New Zealand
14.	Genesis Energy Limited	34.	T & G Global Limited
15.	IAG New Zealand Limited	35.	The Todd Corporation Limited
16.	Infratil Limited	36.	Vodafone New Zealand Limited
17.	Lion Pty Limited	37.	Watercare Services Limited
18.	Meridian Energy	38.	Westpac New Zealand Limited
19.	Methanex New Zealand Limited	39.	Z Energy Limited
20.	New Zealand Post Limited	40.	ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely,

**John Payne** 

For the Corporate Taxpayers Group

#### **APPENDIX ONE: DETAILED SUBMISSION POINTS - GENERAL COMMENTS**

Disclaimer: no comments on practicalities or mechanics of the proposals are intended to be read as an endorsement of the proposals unless explicitly stated.

#### 1. General comments

#### **Timeframes**

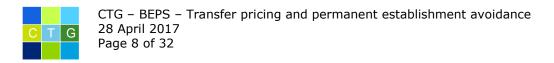
- 1.1 The Group is very concerned that the compressed timeframe for consultation on these issues has not allowed the private sector and other stakeholders of the tax system adequate time to fully work through the issues which may arise from these proposals.
- 1.2 The timing of release of all three BEPS related documents (3 March 2017) was unfortunate as many taxpayers are heavily committed to tax compliance activities during the month of March.
- 1.3 Given the breadth of issues being consulted on and the potential overlap of proposals between this discussion document and *BEPS Strengthening our interest limitation rules* the Group believes that a further round of consultation should take place later in 2017, prior to any changes being included in a tax bill.

#### General comments

- 1.4 The Group understands the need to address the wider BEPS issues in New Zealand and is generally supportive of targeted proposals to protect New Zealand's tax base. It is pleasing to see thought being taken on this issue. However, in the Group's view, the appropriate balance needs to be found between discouraging avoidance behaviour (including by simply using existing tax rules) and encouraging genuine commercial activity. The Group does not think that this balance has been appropriately struck and does not support these proposals proceeding.
- 1.5 It is also important that New Zealand does not rush into new rules before other jurisdictions, and that any measures remain proportional to the problem. As the Commissioner noted in the 2016 Multinational Compliance Focus Document: "In the last few years Inland Revenue has placed an increased level of scrutiny on the tax practices of multinationals. I'm pleased we have found nearly all businesses open and willing to engage with us positively, and proud to contribute to New Zealand."<sup>2</sup>
- 1.6 In the Group's view, these proposals adopt an approach that targets the 'lowest common denominator', in that they apply to a large number of businesses, the majority of which are compliant. The Minister of Revenue, Hon. Judith Collins, noted in her speech to IFA releasing the three BEPS consultation documents: "It is important that these BEPS measures do not lead to unnecessary uncertainty for compliant taxpayers and to unintended double taxation." The Group considers that the current proposals are too broad and it would be more appropriate to target only those taxpayers who are non-compliant.
- 1.7 As inferred in paragraph 2.22 of the discussion document, many of the proposals in the document do not alter the outcomes under the existing law. Inland Revenue should use the full suite of tools currently available to it to resolve BEPS issues. Therefore the Group does not consider these changes warranted given the negative

http://www.ird.govt.nz/resources/6/2/62414b82-6ab8-4017-b04d-cc5d950cab47/compliance-focus-2016.pdf Page 1

<sup>&</sup>lt;sup>3</sup> http://taxpolicy.ird.govt.nz/news/2017-03-03-beps-consultation-documents-released#speech



impact that the perception of these changes may have on investment in New Zealand. Consideration should be given to documenting why the structures / arrangements are unacceptable in an Inland Revenue publication, such as a revenue alert. Paragraph 2.22 states (emphasis added):

Inland Revenue is currently investigating or disputing several BEPS related cases. Nothing in this document is intended to prejudice any of those disputes or investigations. In particular, none of the proposed amendments in this discussion documents should be regarded as evidence that Inland Revenue cannot address the BEPS activities it is currently investigating or disputing under the current law, or that such BEPS activities are within the policy intent of the current law.

- 1.8 In the Group's view, many of the changes proposed are being driven from a service delivery standpoint and not from a "what is best policy" point of view. Fundamental changes to New Zealand's tax system, such as those proposed in this discussion document, should have a clear policy intent behind them and must be for the benefit of New Zealand as a whole. Tax policy changes should not be overtly influenced by ease of application by Inland Revenue staff or be based on "nice to have" tax audit tools.
- 1.9 The Group's overarching concern is that the proposals contained in the issues paper have the potential to significantly impact on the cost of capital for New Zealand businesses. This will actively discourage foreign direct investment, resulting in a detrimental effect on the wider economy. The imposition of complex and burdensome tax rules will actively discourage foreign direct investment into New Zealand or multinational corporations from using New Zealand as a base for their operations. This is because other jurisdictions may become comparatively more attractive than New Zealand to invest in.
- 1.10 If foreign companies no longer invest into New Zealand because the tax rules are too onerous in comparison to the size of the potential market, this will have a direct impact on the New Zealand economy through reduced GDP (growth) and employment levels. There is an obvious negative effect of a loss of revenue for New Zealand (including GST to be claimed) and a reduction of consumer choice. In the Group's view, many of the proposed changes negatively impact the attractiveness of New Zealand as an investment destination. New Zealand's tax system plays a critical role in our competitive position with our major trading partners and competitors. The Group considers that it is important that New Zealand should provide a business environment that is at least as good as that which exists in competing countries, in particular our nearest and most significant competitor, Australia. In this respect it is important to consider the changes occurring in Australia and the perceived impact (whether negative or positive) of those changes.
- 1.11 Tax influences a company's decision to trade in a country, especially companies that are in a low margin business. For example, a member of the Group has noted that if the proposed US tax reforms go ahead and large duties are placed on imports, then it is likely that they will retreat from that market and look at other jurisdictions without such tax barriers. We do not want businesses discouraged from investing in New Zealand in a similar fashion.
- 1.12 The Group is of the view that there needs to be further analysis of the economic impact of these proposals before they can proceed, particularly in relation to the creation of a PE and attribution of profits. Tax changes that have the potential to increase the cost of capital and / or restrict the flow of foreign capital should not be made lightly and full consideration must be given to the economic impact of these

proposals. It is the Group's view that the proposals have the narrow focus of tax revenue enhancement and there is little evidence in the issues paper that the broader economic issues have been considered in any meaningful way. There must be a broader enquiry into the likely economic effect of these proposals before they proceed any further.

## Certainty, compliance costs and competitiveness

- 1.13 The Group believes that a good tax system should be built around three principles in particular: certainty, compliance costs and competitiveness. As noted above, it is important that international competitiveness is maintained, especially in relation to Australia, as higher costs of doing in business in New Zealand flow through to less investment, fewer jobs and lower wealth. New Zealand's tax system plays a critical role in the attractiveness of New Zealand for both inbound and outbound investment. For New Zealand to remain competitive it is important that it is recognised that complex taxes can cause significant compliance cost for businesses.
- 1.14 The Group appreciates that Inland Revenue may find auditing multinational organisations "resource intensive" (as noted in paragraph 3.13). However this does not justify imposing large compliance costs on all compliant taxpayers. Compliance costs are a 'deadweight economic cost' that represent resources consumed for the production of very little (or nothing at all). These resources would be better employed creating jobs and raising the wealth of New Zealand. In the Group's view, these proposals will shift significant compliance costs onto taxpayers and this is only justified where the benefits outweigh the costs.
- 1.15 The Group considers that overall, these proposals will be detrimental to tax certainty for taxpayers. The proposals add unnecessary complexity to the rules and increase business risk by creating uncertain or unexpected tax outcomes. For the corporate sector, tax is not just a cost of doing business but is also a very significant risk by creating uncertain or unexpected outcomes. To lower business risks caused by the tax system, tax rules need to be administered and interpreted consistently and quickly, and should be as simple as possible to increase certainty. In the Group's view, the proposals as they currently stand increase complexity without any corresponding benefit.

### Diverted Profits Tax and Multinational Anti-Avoidance Law

- 1.16 The Group is pleased to see that a diverted profits tax ("DPT") has not been recommended. In the Group's view, a DPT would discourage investment in New Zealand and may arbitrarily impose tax on compliant taxpayers. The Group supports the view in last year's Cabinet Paper that a tailored approach is more appropriate for New Zealand.<sup>4</sup>
- 1.17 As noted in the Cabinet Paper, a DPT "could impact on foreign investor's perceptions of the predictability and fairness of New Zealand's tax system for foreign investment". Even if a DPT has not been introduced, many of the proposed changes carry the same effect and there are elements of the proposals that are similar to a DPT (absent the punitive tax rate). Caution must be taken as the same arguments in relation to discouraging investment apply. The introduction of cumbersome and prescriptive rules reduces the attractiveness of New Zealand as an investment destination.

Measures to strengthen transfer pricing rules and prevent permanent establishment avoidance – a Government Discussion Document.

1.18 In our workshop, Officials indicated that the rules are intended to act as a multinational anti-avoidance law ("MAAL"). The Group cautions against introducing a MAAL for the same reasons it does not support a DPT. If it is intended that a MAAL is introduced, it should be consulted on as a MAAL and full consultation should be undertaken on its features, as was the case when Australia introduced its MAAL.

## Interaction with existing treaty framework

- 1.19 In the Group's view, it is unclear how the proposals will fit into New Zealand's existing treaty framework. It is important that care is taken to consider the views of our treaty partners and their approach to this issue. If they respond in a similar way, there will be a risk that New Zealand's tax take is reduced (rather than being increased) due to other tax authorities taking the same action. Further, New Zealand businesses trading overseas may encounter greater taxes due to the changes, leading ultimately to less global trade which is clearly contrary to the Government's economic growth agenda.
- 1.20 It is noted that France has adopted a DPT, but in doing so, acknowledged that the definition of a permanent establishment in a relevant tax treaty would prevent the application of the DPT<sup>5</sup>.
- 1.21 Officials have positioned the PE proposal as an avoidance rule however at our workshop with Officials it was suggested that the rule goes beyond even the expanded definition of a PE as included in the multilateral instrument and to be included in the OECD model treaty. Officials conceded that there may be instances where the expanded treaty definition does not apply but this domestic PE avoidance rule would deem a PE to exist. In the Group's view this takes the proposal beyond an avoidance rule and results in the fundamental shifting of the PE boundary beyond what has been agreed globally at OECD and with our treaty partners. This type of unilateral action is not justified particularly given the numerous occasions officials and successive Ministers of Revenue had publically confirmed New Zealand's commitment to the OECD BEPS project and the actions agreed globally. This action harms our reputation as an investment destination and a place where business can be conducted with ease.

## Application date

- 1.22 The Group does not support the proposed application date for the administrative rules being the date of enactment of the relevant legislation. In the Group's view, it is fundamentally uncertain to have the date of enactment as the application date of a proposal. In particular, such a date is not appropriate where it introduces significant changes that may impact arrangements that have been in place for a number of years without previous challenge by the Commissioner.
- 1.23 As taxpayers have experienced from the recent enactment of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 on 30 March 2017, having only two days' lead in time before the next income year begins does not give taxpayers adequate lead in time. The Group considers that taxpayers should be able to plan their future business with a degree of certainty and be afforded the opportunity to consider their options moving forward. All existing arrangements should have appropriate grandparenting.

https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-france-23-december-2016.pdf

1.24 The Group submits that the Commissioner should clearly establish the status of existing advanced pricing arrangements ("APAs") as a consequence of any changes enacted. The Group notes that binding rulings are binding on the Commissioner until there is a legislative change and queries whether the position will be the same for APAs. In the Group's view, it is important to establish a position to reduce any uncertainty taxpayers may face in light of the changing environment. The Group considers that all existing APAs should be grandparented and allowed to run their course, particularly given they often only run three years. Without grandparenting, taxpayers are dis-incentivised to engage with Inland Revenue in the interim as the high cost of obtaining an APA proportionally increases if the length of the APA is shortened.

# APPENDIX TWO: DETAILED SUBMISSION POINTS - PERMANENT ESTABLISHMENT AVOIDANCE

Disclaimer: no comments on practicalities or mechanics of the proposals are intended to be read as an endorsement of the proposals unless explicitly stated.

## 2. Permanent establishment avoidance

## Summary

- 2.1 The Group is concerned that these proposals are inconsistent with the purpose of DTAs. At a minimum, these proposals should only apply where New Zealand does not have an applicable DTA in place.
- 2.2 The Group is concerned about the sentiments expressed in paragraph 3.36 of the Discussion Document in relation to attribution to deemed PEs.
- 2.3 Taxpayers should have certainty about when these rules will apply by having a New Zealand dollar turnover threshold or ensuring that the threshold is set with reference to a previous fiscal year.
- 2.4 There are genuine commercial reasons why contracts may not be concluded in New Zealand. For example, it is not efficient for a multinational to have a legal team in every jurisdiction in which it operates. Having efficient and centralised management functions should not be prejudged as PE avoidance.
- 2.5 Inland Revenue needs to provide clear guidance to taxpayers about how profits should be attributed to PEs. The rules cannot act as a "force of attraction" principle and seek to bring into the tax base all New Zealand sales revenue simply because some functions are carried on in New Zealand. Any attribution of profit to New Zealand must reflect the actual degree of activity and effort in New Zealand value added outside of New Zealand cannot be taxed in New Zealand.

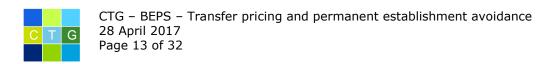
## Large multinational threshold

2.6 The Group submits that the large multinational threshold (non-residents part of a multinational group with more than €750 consolidated global turnover) should be given an equivalent New Zealand Dollar value (e.g. NZ\$1.15b), as it would be inappropriate to have a large company fall in and out of the rules based on exchange rate volatility. This approach would be consistent with Australia's adoption of an AU\$1b threshold. Alternatively, the Group submits that the threshold could adopt the wording of the OECD country-by-country threshold (MNE groups with annual consolidated group revenue in the immediately preceding fiscal year of more than €750 million or a near equivalent amount in domestic currency)<sup>6</sup>. This would also clarify the date / point at which the threshold is to be measured and provide certainty to taxpayers as to whether they meet the threshold.

## Permanent establishment test

2.7 The Group submits that there are valid commercial reasons why multinationals may conclude contracts outside of New Zealand (for example to centralise management functions to improve management practices and reduce corporate risk). This is not necessarily about PE avoidance and obtaining a tax advantage, but relates to the size and importance of New Zealand relative to the rest of the multinational organisation.

<sup>6 &</sup>lt;u>https://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf</u>



For example, in many instances it does not make sense for the multinational to have a legal team based in New Zealand (and every other jurisdiction it operates in). Any proposed rule must focus on arrangements that are artificial and contrived to ensure that legitimate commercial arrangements are not captured.

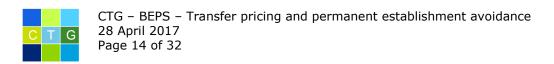
- 2.8 The discussion document notes at paragraph 3.22 that "only activities designed to bring about a particular sale should potentially result in a deemed PE" and any activities that are merely preparatory or auxiliary are not sufficient to trigger a possible PE. The Group submits that additional guidance should be given as to the degree of connection required with sales into the New Zealand market, and whether this requires direct connection with a specifically identifiable sale that is in the contemplation of the New Zealand related party at the time it carries out its activity. As an example, will marketing activity that directs consumers to a website operated by a non-resident amount to the New Zealand related entity carrying out activity in connection with any resulting sale by the non-resident? Similar clarification should be provided as to the meaning of the "for purpose of bringing it about" and the requisite connection of the activities to the ultimately successful sale by the non-resident.
- 2.9 The Group considers that a natural consequence of the introduction of these rules could be for non-residents to stop hiring any staff in New Zealand. This will have a detrimental effect to the New Zealand economy, the cost of which needs to be weighed against any proposed changes.
- 2.10 The Group submits that it is important that any avoidance rule introduced is consistent with OECD and our international obligations. The current proposals fail on that front. For example OECD standard language in relation to concluding contracts is as follows:

"habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise via an intermediary"

Whereas the proposed New Zealand rule encompasses the following:

Utilise New Zealand-based staff to support the sales function, through a New Zealand subsidiary, branch or "dependent" persons or entities contracted to an off-shore entity.

- 2.11 It does not make sense to depart from language and concepts that are already internationally recognised and understood.
- 2.12 New Zealand should not be implementing rules when it would not be comfortable with other countries imposing those same rules on New Zealand exporters. The Group believes that the application of a similar rule to that being proposed in the discussion document by overseas jurisdictions presents a real risk to New Zealand's revenue base. This is especially relevant noting that the New Zealand economy is export driven with growing exports being the key plank in the Government's economic growth policy.
- 2.13 At our workshop with you we discussed the example of a New Zealand company selling product into Japan (or any other country). In this example the company had two employees on the ground in Japan who are responsible for liaising with clients and facilitating orders (noting that contracts are concluded outside of Japan). The reason for adopting this sales strategy is largely cultural. Experience has shown this



company that Japanese customers prefer to deal with someone who is in country, speaks Japanese and understands local customs.

- 2.14 In the Group's view, in this example the activity in Japan should not give rise to a permanent establishment. However, at the meeting Officials noted that based on the current proposal in the discussion document they consider this scenario to be 'close to the line' and could in fact give rise to a PE in Japan. The Group submits that if this is the case New Zealand must be prepared for Japan to deem a PE to exist and take a share of the profits. It is the opinion of the Group that this is a wholly undesirable outcome, yet there doesn't appear to be any consideration of the implications of overseas jurisdictions applying this type of PE avoidance rule.
- 2.15 At the workshop, Officials indicated that pure marketing activity undertaken by an organisation is not sufficient to give rise to a PE. However, if there is customisation for a particular sale, a line is crossed and a PE may exist with profits attributed to it accordingly. In this scenario the Group would expect that all 'business development' costs should be deductible. In many business models there can often be several lost sales for every sale that is actually converted. If New Zealand wishes to take a share of the completed sales, costs associated with the unsuccessful sales in New Zealand should also be deductible against the income of the "deemed PE".
- 2.16 As the Group has discussed with Officials, New Zealand has a very small domestic market. The reality of this is that, even if a particular taxpayer were inclined to use "profit-shifting" techniques, the application of such techniques to New Zealand operations would serve very little benefit. The majority of taxpayers just want to get on with running their business, which includes complying with all relevant tax laws. To do this, laws need to be clear and certain. The Group submits that the proposed PE avoidance rule creates significant uncertainty which would be a undesirable feature of our international tax rules.
- 2.17 The Group submits that the factors in determining whether the PE test is met (see paragraph 3.24 of the Discussion Document) should be clarified. In particular, the definition of "well paid" employees should be clarified as the Group considers that just because staff are "well paid", that does not mean that they have authority to conclude contracts. Recent transfer pricing questionnaires indicate that Inland Revenue considers staff to be "well paid" if they earn over \$150,000 per annum. Members have noted that often they have a handful of New Zealand staff working overseas, managing a team of local staff in their overseas operations and that these New Zealand staff are paid well because it is necessary to have trustworthy staff overseeing operations. The level of pay does not relate to any decision-making ability. The Group also queries whether, in the case of a foreign PE of a New Zealand resident taxpayer, the Commissioner would expect a greater level of profit to be attributed to the PE on account of its employment of "well paid" staff.
- 2.18 The Group submits that guidance should be given as to the meaning of "low tax jurisdiction" (see paragraph 3.24). At this stage it is unclear what this refers to -whether it is a reference to the country's corporate tax rate, their tax system more broadly or some other measure. Given the importance of this as a factor and to provide some certainty to taxpayers, the Group submits that the Government should publish a list of countries whose tax systems it considers to have the features of a "low tax jurisdiction". The Group notes this approach was used successfully under New Zealand's former Foreign Investment Fund rules and a list of low tax jurisdictions is also included with Transfer Pricing Questionnaires issued by the Commissioner. For example, would the corporate tax rates of the important markets of the UK (17%)

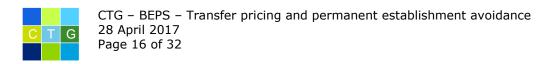
and the US (15%, assuming announced reforms are enacted) deem them to be low tax jurisdictions?

2.19 Paragraph 3.36 of the discussion document states (emphasis added):

We expect that the application of these principles will result in a fairly significant amount of the sales income being attributable to the deemed PE in most cases. We also expect a material amount of net taxable profit to remain in the PE after the deduction of related expenses. In this regard, we note that New Zealand, like many countries, has not adopted the OECD's revised methodology for attributing profits to a PE. The OECD's revised methodology is also not currently reflected in many DTAs. New Zealand instead applies the earlier version of the OECD's methodology.

- 2.20 The Group is concerned about the sentiments expressed in paragraph 3.36 and considers that the application of the proposals should be clarified, in particular what is meant by "fairly significant" and "material amount" in relation to sales income being attributable to the deemed PE and the net profit to remain (see paragraph 3.36). Thought should be given to the outcome if other countries also seek to grab a "fairly significant" and "material amount" of tax from New Zealand exporters. As noted previously, in the absence of clarity, taxpayers are likely to err on the side of caution and not place any personnel in New Zealand due to the lack of certainty in profit attribution. The Group acknowledges that foreign investors are willing to accept a New Zealand tax liability, but in making their decision rely on being able to cost future commercial arrangements accurately. It is important to make New Zealand as attractive as possible to encourage future inbound investment into New Zealand.
- 2.21 The Group notes that there are PE rules in DTAs, PE rules in the OECD Action 5 material and the PE rules as proposed in this discussion document. In the Group's view, the proposed rules as they are worded in this discussion document merely add complexity to the rules. The Group submits that the wording of Action 5 should be used where possible, as these are the standards that other countries will be implementing.
- 2.22 It is critical that, if these proposals proceed, Inland Revenue should provide clear commentary for taxpayers on how it considers profits should be attributed to PEs. The rules cannot act as a "force of attraction" principle and seek to bring into the New Zealand tax base all New Zealand sales revenues simply because some functions are carried on in New Zealand. Any attribution of profit to New Zealand must reflect the actual degree of activity and effort in New Zealand value added outside of New Zealand cannot be taxed in New Zealand.
- 2.23 Under New Zealand's existing profit attribution principles, it is expected that the "profit calculated as being linked to the PE is in line with that which would be expected from a comparable business operating entirely at arm's-length." In effect this means that the PE should earn a profit that is consistent with its functional profile. As this is not different to what is expected of legally separate entities, where a deemed PE is established by operation of the proposed rule, the profit taxable in New Zealand is unlikely to be higher than that currently provided to the New Zealand entity under the transfer pricing rules. In that event, the proposed rule would have no effect, other to impose significant and unnecessary compliance costs on the non-resident and risk non-residents eliminating jobs and investment in New Zealand.
- 2.24 In the Group's view, departing from such core principles risks New Zealand falling out of step with the rest of the world, in turn risking retaliatory action in jurisdictions

http://www.ird.govt.nz/transfer-pricing/practice/transfer-pricing-practice-branches.html



in which we operate. New Zealand's best chance of ensuring that its exports are not overtaxed is to ensure that it does not act unilaterally and seek to assert taxing rights over revenue where the income earning activity (including IP) is located outside of New Zealand. It is extremely important to remember that the New Zealand rules do not stand alone and must be considered in the context of the worldwide environment.

## Arrangements involving third party channel providers

- 2.25 The Group submits that the proposed rules should not cover arrangements where sale of supplies are made to a non-affiliated entity. It is intended that the proposed rules will also apply where an independent third party is interposed between the non-resident and the New Zealand customer as part of the arrangement. The discussion document suggests (at paragraph 3.29) that the non-resident and third party are working together to sell the particular goods or services to the end customer with the assistance of the related New Zealand entity.
- 2.26 In the Group's view, in the majority of these situations the non-resident will not have control over the sales activities of the third party and the arrangements do not amount to a "single arrangement" as discussed at paragraph 3.28, and therefore the proposed PE rules should not apply. The unrelated nature of the non-resident and the third party means that the transactions between them are at arm's length. The Group considers that distributors and retailers will operate independently and will not contravene the purpose of the DTA PE rules, noting that the sales by the third party are already within the New Zealand tax net.
- 2.27 The Group acknowledges that there may be limited situations where a related subsidiary works closely with, or directly controls, the activities of the unrelated third party. However, in the Group's experience, this arrangement does not occur in practice and if it does, then any detrimental tax effect may be able to be caught by the anti-avoidance rules in subsection GB of the Income Tax Act 2007. Accordingly, it is not justification for the proposal to fundamentally change New Zealand's approach to the concept of permanent establishment.
- 2.28 The Group submits that the proposed rules should be limited to situations where the sale is made directly by the non-resident to the New Zealand customer.

# Purpose of the PE provisions

- 2.29 The rules proposed in paragraphs 3.21 and 3.27 both contain a criterion that "the arrangement defeats the purpose of the PE provisions". The Group submits that any such criterion should refer to the *dominant purpose* of the arrangement.
- 2.30 The Group also submits that it should be clarified what the "purpose of the DTA's PE provisions" is in relation to the deeming of a PE in New Zealand (as per paragraphs 3.21 and 3.27). In the Group's view, whether an organisation has a PE or not is an 'in or out' test an organisation either has enough of a presence in New Zealand or not. The Group queries whether an organisation that is close to having a PE but doesn't have quite enough 'presence' could be considered to have defeated the purpose of the provisions.
- 2.31 The Group considers that the focus should be on artificial arrangements. There are many unusual commercial arrangements that are undertaken for genuine commercial reasons. The discussion document notes at paragraph 5.45 that there is an increasing variety of commercial arrangements being undertaken by multinationals and

consideration should be given to this. These arrangements are not inherently to avoid tax and merely represent the evolving nature of business.

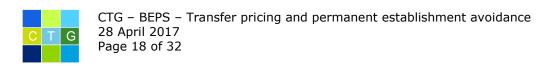
- 2.32 The Group considers that this proposal should not have the effect of overriding New Zealand's DTAs. It is important that taxpayers continue to have access to MAP and arbitration procedures guaranteed in New Zealand's network of treaties.
- 2.33 The Group submits that these proposals should not apply to arrangements involving countries with which New Zealand has a DTA. Further, New Zealand should not be looking to impose a rule beyond what has been agreed by OECD. Any domestic PE avoidance rule should follow the language used in the OECD model treaty.

#### *Inconsistencies*

- 2.34 Paragraphs 3.21 and 3.27 set out proposed rules where PEs will be deemed to arise. Notwithstanding the Group's comments on these paragraphs above, the Group notes there is an inconsistency in terminology between paragraphs 3.21 and 3.27 of the discussion document. 3.21 describes an activity "in connection with", while 3.27 describes an activity "in relation to". The Group considers that this wording should be consistent in order to avoid any confusion.
- 2.35 Similarly, the Group also submits that the inconsistency between "that particular sale" in 3.21 and "the sale" in 3.27 should be consistent.
- 2.36 The Group notes that, at paragraph 3.21, a PE will be deemed to exist where certain criteria are met, including where "some or all of the sales income is not attributed to a New Zealand PE of the non-resident". These rules deal with deeming a PE to exist, not how to attribute profits as suggested by the above phrase. In the Group's view, the wording of this particular criterion does not make sense and should read as "none of the income is attributed to the PE" as, if some but not all of the income is attributed to the PE, any shortfall arises due to issues with the application of the profit attribution rules, and not the PE recognition rules.

#### **Penalties**

2.37 The Group does not agree with the proposal at paragraph 3.38 that "the current 100% penalty for taking an abusive tax position (under section 141D of the Tax Administration Act 1994) will also apply for the purposes of the proposed PE avoidance rule." The Group does not consider that the abusive tax position penalty, or even the unacceptable tax position penalty should automatically be applied in these situations. These penalties should only apply to extreme cases.



# APPENDIX THREE: DETAILED SUBMISSION POINTS - AMENDMENTS TO THE SOURCE RULES

Disclaimer: no comments on practicalities or mechanics of the proposals are intended to be read as an endorsement of the proposals unless explicitly stated.

## 3. Amendments to the source rules

### Summary

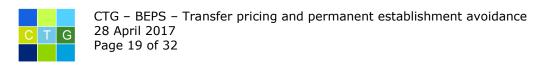
- Amendments are unnecessary as the existing source rules are comprehensive.
- The proposals unfairly penalise reinsured parties.

## Proposed source rules

- 3.1 In the Group's view, the proposed changes to the source rules are unnecessary as the current source rules are sufficiently broad to capture any situations the Commissioner is concerned with. Under the current rules, if sales income has a New Zealand source under our domestic legislation it is taxable unless New Zealand is prevented from doing so under any applicable DTA.
- 3.2 Paragraphs 4.23 and 4.23 do not respect the existing source rules in part YD of the Income Tax Act 2007 which clearly contemplate apportionment through the use of the words "to the extent...". At the end of the day, New Zealand can only tax what has an actual source in New Zealand.
- 3.3 It is proposed that a new source rule be introduced under which income will have a New Zealand source if it is attributable to a PE in New Zealand. If a DTA applies in respect of the income, then the definition of a PE in that particular DTA will be used for this purpose. In the Group's view, the addition of this rule is circular and does not add anything to the rules. It is a belts and braces approach and it is hard to envisage a situation in which the proposed source rule will be employed that is not already covered.

## Life insurance source rules

- 3.4 The Group understands the life insurance source rule proposal has been introduced due to the (theoretical) possibility that there may be tax relief for New Zealand sourced insurance if the reinsurer is resident in Singapore, Canada and Russia and doesn't have a PE in New Zealand. This is due to the fact that New Zealand's DTAs with these countries carve out life insurance income from the business profits exemption in Article 7 i.e. non-resident life insurers who are residents of one of the above three countries receive an (unintended) tax advantage by being able to deduct reinsurance premiums.
- 3.5 The Group submits that the proposals unfairly penalise the reinsured by placing a significant burden on them with regard to the denial of deductions. In particular, they cannot be expected to have completeness of information regarding their insurers' place of tax residency and PE status in New Zealand.



# **APPENDIX FOUR: DETAILED SUBMISSION POINTS - TRANSFER PRICING RULES**

Disclaimer: no comments on practicalities or mechanics of the proposals are intended to be read as an endorsement of the proposals unless explicitly stated.

## 4. Strengthening the transfer pricing rules

## Summary

- Overall the Group does not believe that further strengthening of the transfer pricing rules are required. Inland Revenue already has a number of tools available to it and these tools should be applied. Inland Revenue should ensure that it is appropriately resourced with transfer pricing expertise in order to ensure that it is able to apply the rules as they currently stand, and do so within the current four year time bar period.
- Any powers of reconstruction need to be limited to only the most extreme circumstances and should only be assessed at the highest levels within Inland Revenue. The same applies for the deeming of any taxpayer to be non-cooperative.
- The Group does not support the extension of the time bar to seven years. This proposal is counter to Inland Revenue providing more certainty to taxpayers.
- The Group does not support shifting the burden of proof to taxpayers. The Group is concerned that Inland Revenue has access to comparables which are not available to taxpayers.
- The Group would like to see Inland Revenue provide an online resource setting out what OECD materials expect taxpayers to be following.
- The Group foresees difficulty in applying transfer pricing rules to investors acting in concert. The mere fact that there are unassociated parties coming together indicates there should already be arm's length pricing in place; i.e. there is natural tension to ensure each party is not receiving more than their fair share.

## Time bar

- 4.1 The Group does not support the extension of the time bar for transfer pricing positions to seven years. This represents a 75% increase in the time bar, which in the Group's view, goes against Inland Revenue's customer centric approach and incentivises bad behaviour by Inland Revenue in not closing out matters in a timely manner. The Group understands that one of Inland Revenue's Business Transformation goals is to provide more "real time" advice, information and assurance, as well as to encourage taxpayers to "get it right from the start". This proposal is inconsistent with these principles.
- 4.2 The Group notes that Inland Revenue's compliance management approach for multinational enterprises has been to move to resolving issues with commercial transactions in real time. This approach has been achieved through provision of more pre-filing reviews and risk reviews and has allowed for practical certainty in a short period of time (well within the four year time bar).



- 4.3 The Group submits that the proposal to extend the time bar is particularly egregious given the nature of transfer pricing arrangements and disputes. These arrangements are fundamental part of the way a taxpayer structures their business and for this reason will generally span several income years. The Group notes these are not one-off events (like many other tax disputes) and there will be an impact year after year. To have tax years open for seven years leaves taxpayers open to far too much risk and uncertainty.
- 4.4 The discussion document asserts that the extension of the time bar will bring New Zealand in line with other countries. New Zealand operates in a smaller marketplace than these other countries, and the Group considers that an adequately resourced Revenue should be able to complete this process within four years.
- 4.5 The discussion document uses the time bar period of other jurisdictions as justification for increasing the time bar. However the Group submits that the selection of seven years is simply an example of "cherry picking" the worst option for taxpayers as this is the longest time bar (excluding China who applies a ten year time bar across all taxes, not just transfer pricing). As is shown from the table below (taken from paragraph 5.70 of the discussion document), the majority of jurisdictions do not differentiate between the time bar applying to transfer pricing vis-à-vis other tax issues. It is difficult to understand why Inland Revenue does not consider itself able to complete its transfer pricing reviews within the same time period that applies for other complicated areas of tax such as financial arrangements and tax avoidance.

Country	Transfer pricing time bar	Standard time bar for other tax matters
China	10 years	10 years
Australia	7 years	4 years
Canada	7 years	4 years
Malaysia	7 years	5 years
Hong Kong	6 years	6 years
Japan	6 years	5 years
Ireland	4 years	4 years
Germany	4 years	4 years
UK	4 years	4 years
US	3 years	3 years

- 4.6 The Group also submits that increasing the time bar puts New Zealand at risk of transfer pricing reassessments. In particular, other jurisdictions will have longer to claim a larger share of revenue which has been taxed in New Zealand. On the other hand, New Zealand businesses who find themselves subject to transfer pricing adjustments in New Zealand will not have the benefit of obtaining offsetting reassessments in the other jurisdiction if that country's time bar period is shorter (e.g. Hong Kong, Japan, Ireland, Germany, UK and US).
- 4.7 The Group submits that if the time bar is to be raised (which we disagree with), it should only be raised by one or two years and then only for non-cooperative taxpayers (see below for more discussion on what is a non-cooperative taxpayer). The Group notes that there are significant costs involved in a transfer pricing dispute and extending the time bar to seven years will only increase these costs. These costs will be compounded by the proposed administrative measures discussed below.

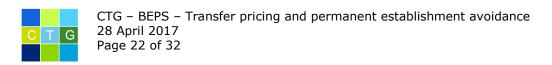
4.8 If the time bar is extended, the Group submits that the extended time bar should only apply to tax returns filed <u>after the date of enactment</u>. All tax returns filed before enactment should still be subject to the four year time bar in place when those returns were filed.

## Burden of proof

- 4.9 The Group does not support shifting the burden of proof from the Commissioner to the taxpayer. In the Group's view this shift, coupled with an increase in the time bar, significantly increases compliance costs imposed on taxpayers without a sufficient trade off. The Group submits that the burden of proof should remain with the Commissioner if the taxpayer has been preparing documentation and has been open and transparent with the Commissioner.
- 4.10 However, if the onus does shift, then it is important that the information required to prove that a particular transaction is arm's length must be limited to publicly available information / comparables. If the Commissioner seeks to rely on "secret information", then that information must be disclosed or it cannot be relied on in in the dispute, including Court proceedings. If such information cannot be disclosed without breaching confidentiality, then it is not appropriate that the Commissioner have regard to that information.
- 4.11 The Group submits that if a taxpayer has sufficient proof that a transaction is within a range that can be considered arm's length, then Inland Revenue should not be able to tell a taxpayer that the transaction should have been completed at a different point within that range without providing the taxpayer with detailed economic analysis to support that position. For example, a taxpayer may have prepared a benchmarking study and identified an arm's length range of comparable margins between 2%-4% (supported by compliant transfer pricing documentation). The taxpayer may choose to apply the 2% margin because this is consistent with what they have done globally and is appropriate given the functional profiles of the relevant parties. However, it may be difficult for the taxpayer to negate an assertion by Inland Revenue that 4% is a more appropriate rate. In the Group's view, in this situation Inland Revenue should not be able to insist on the 4% result merely because it is also in the range supported by the taxpayer's benchmarking study.

# OECD guidance

- 4.12 The Group submits that Inland Revenue should have links to the OECD Guidelines available on its website so that taxpayers can easily access this information. This will increase certainty as it is important that taxpayers have easy access to the rules that may affect them.
- 4.13 In the Group's view, if the OECD Guidelines are referenced in legislation it must be made clear what will occur if the OECD makes changes to the Guidelines. The Group submits that the legislation should contain reference to the OECD Guidelines that apply at the time a return is filed. The legislation should also reference reservations New Zealand may have entered in to and note that the guidelines will not apply to the extent of any of these.
- 4.14 Officials observe at 5.23 that "Inland Revenue and taxpayers routinely apply the latest versions of the guidelines in cases from earlier years, as the guidelines are generally consistent with our existing law." The Group notes that in practice this approach is only acceptable to the extent that it is not detrimental to the taxpayer.



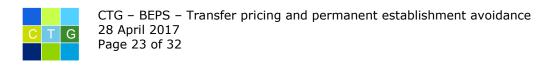
It is inappropriate for the Commissioner to retrospectively rely on guidance that was not available to the taxpayer at the time its tax position was taken.

## Arm's length conditions

- 4.15 It is proposed that the transfer pricing rules will move away from an assessment of the appropriateness of arm's length consideration to one of the "arm's length conditions". While little detail has been provided in the discussion document, Officials propose that this change will be aligned with the provisions present in Australia.
- 4.16 The Group notes that "arm's length conditions" are a much more difficult to identify than arm's length consideration. This is because the transfer pricing methods routinely applied in assessing cross-border transactions between associated parties typically identify only a comparable price or margin (or a range thereof) for a certain type of transaction.
- 4.17 Where the Commissioner seeks to look beyond this, to the wider terms and conditions of the arrangement, it becomes more difficult to support any proposed adjustment based on anything more than hypothetical constructs. The Group therefore submits that legislation and guidance must be clear as to the situations in which the Commissioner can establish "arm's length conditions" other than those identified by the taxpayer, and what must be provided to support this.
- 4.18 The Group is also concerned that the move away from arm's length consideration to "arm's length conditions" may see investigators seeking to adjust a taxpayer's result, rather than the underlying transactions. The Group considers that it is critical that any adjustment to align a taxpayer's result with "arm's length conditions" must be aligned with an adjustment to an identifiable transaction. This is because adjustments to different transactions may have different tax implications. For example, if a taxpayer enters into both services and royalty transactions with foreign associates and the Commissioner seeks to reassess the taxpayer's tax position, it is important for the taxpayer to know whether it is the services transaction or royalty transaction that is adjusted. This is because royalties typically attract withholding tax obligations, while service fees do not. These considerations flow through any attempt to gain equal and opposite treatment in the jurisdiction of the foreign related party.

# Reconstruction of transactions

- 4.19 The Group notes the Commissioner already relies on an assessment of economic substance of cross-border associated party transactions when assessing the appropriateness of the consideration paid or earned under their legal form.
- 4.20 The Group submits that there need to be sufficient controls put in place when the Commissioner wishes to reconstruct a related party transaction. The Group notes that this power is essentially the Commissioner telling a company how to run its business, and this kind of decision should only be made in "exceptional circumstances". The Group notes that there are a large number of commercial tensions that work to influence a transaction and it should not be up to the Commissioner to judge the appropriateness of these (unless there are significant enough grounds to do so). In the Group's view, "exceptional circumstances" can be tested objectively (and is not measured by "uniqueness" as suggested by the discussion document at paragraph 5.39).
- 4.21 When reviewing transactions, Inland Revenue is doing so with the benefit of hindsight something taxpayers do not have at the time they are running their business. When



considering the appropriateness of commercial arrangements, Inland Revenue should be putting themselves in the shoes of the taxpayer at the time the transaction / arrangement took place.

- 4.22 The Group submits that it must be clearly defined what activities / transactions are "aggressive" and "commercially irrational". It must be clear to taxpayers what the rules are and what the standard to be maintained is. The Group also submits that there needs to be structure and transparency around who decides what is an "aggressive" or "commercially irrational" transaction and the process for deciding this. This is necessary to protect taxpayers from overzealous investigators.
- 4.23 As noted for "arm's length conditions" above, the Group considers that it is important for any reconstruction by the Commissioner under the proposed reconstruction provisions to be aligned with an actual cross-border arrangement. This is particularly important where taxpayers may enter into a number of transactions, some of which attract withholding obligations.

## Transfer pricing documentation

- 4.24 The Group appreciates that Officials do not currently consider it necessary to include a legislative requirement for taxpayers to prepare contemporaneous transfer pricing documentation. However, the Group is concerned about inconsistencies between statements in the discussion document and experience in practice.
- 4.25 Specifically, the Group notes that the discussion document states at paragraph 5.65 that:

"Inland Revenue would already apply a 'lack of reasonable care' penalty to incorrect transfer pricing positions taken by taxpayers who have failed to adequately document their transfer pricing positions at the time those tax positions were taken."

In practice, the Group notes that it is common for penalties to be levied only where a taxpayer has failed to provide transfer pricing documentation following a request, and prior to commencement of an audit. This does not require the documentation to have been prepared prior to the filing of the income tax return. In light of this, the Group considers that clarity is needed if the Commissioner will now pursue penalties for "lack of reasonable care" if a taxpayer cannot prove that its documentation was prepared prior to the filing of the tax return.

4.26 The Group considers that this is critical for certainty and would prefer confirmation that contemporaneous documentation is required for penalty protection (as in the Australian legislation), over potential ambiguity.

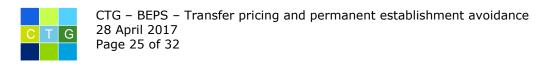
#### The transfer pricing team / resources

4.27 It is important that Inland Revenue is appropriately resourced with skilled transfer pricing resource so that audits can be completed efficiently and the disputes process can run as intended (i.e. there are <u>independent</u> transfer pricing experts available to participate in taxpayer conferences, adjudication and arbitration). Currently there are so few transfer pricing Principal Advisors within Inland Revenue that it is not possible to obtain an independent / impartial review of a dispute and positions become entrenched.

- 4.28 There also needs to be sufficient resourcing to allow for an increase in the volume of APAs that will likely be sought if these proposals are enacted.
- 4.29 The Group notes that for many taxpayers the costs of obtaining an APA are too great for an APA to be a realistic option. Paragraph 5.40 of the discussion document encourages taxpayers to seek APAs to increase certainty. The Group notes that to obtain an APA is a long process that can often end up being very expensive. In the Group's view, if APAs are to be encouraged, it is important that the process is as streamlined as possible (and as noted above, sufficient resources must be allocated to a team dedicated to this work). The Group also notes that any position that would be agreed under a unilateral APA should be equally acceptable if supported through transfer pricing documentation outside the APA programme.
- 4.30 As mentioned above, an adequately resourced Revenue should be able to deal with transfer pricing issues within a reasonable time. Taxpayers should not be unfairly penalised with additional compliance costs and uncertainty because there is a lack of resources available.

## Investors acting in concert

- 4.31 The Group sees real difficulty with the proposal to apply transfer-pricing rules to investors acting in concert. Where the investors do not have the same economic interests, natural pricing tension will ensure pricing for goods or services by one shareholder is at an arm's length rate. Treating a different group of persons as the one economic entity would not, therefore, reflect the economic reality unless all members of that group had the same proportional economic interests (for example, all were supplying the good or service in proportion to their shareholding).
- 4.32 The Group therefore suggests that the proposal should only apply where:
  - a. the New Zealand investment is 50 percent or more owned by non-residents; and
  - b. those non-residents have the same proportional economic interest in the transaction to which the transfer pricing rules are sought to be applied to.
- 4.33 Clarification should also be provided as to whether this association would also make transactions by members of the investors' groups with the New Zealand entity subject to the transfer pricing rules.
- 4.34 The Group notes that to the extent transactions are not priced correctly, there may be a transfer of value potentially giving rise to a deemed dividend. For example, if a New Zealand subsidiary were to pay greater than market value for goods purchased from a shareholder, the dividend rules would likely apply to this arrangement as there has been a transfer of value caused by a shareholding relationship.



## **APPENDIX FIVE: DETAILED SUBMISSION POINTS – ADMINISTRATIVE MEASURES**

Disclaimer: no comments on practicalities or mechanics of the proposals are intended to be read as an endorsement of the proposals unless explicitly stated.

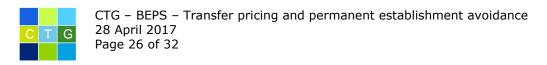
#### 5. Administrative measures

#### **Summary**

- There will need to be clear guidelines as to when a taxpayer may be deemed to be "non-cooperative" and ideally this should be defined in legislation. A taxpayer should not be considered non-cooperative if they are just exercising their rights.
- A taxpayer should have the right to apply to the high Court to challenge any decision of Inland Revenue to deem the taxpayer non-cooperative.
- The Group does not support the requirement to have tax collected earlier in disputes or to allow tax to be collected from associated parties. The Group does not believe that multinationals represent a real credit risk.
- The Group does not support the restriction on the use of tax pooling for disputes involving transfer pricing.
- The Group does not support implementing penalties of \$100,000 for failing to provide information.
- Any changes implemented need to be complemented by appropriate grandparenting provisions for existing arrangements. Taxpayers need to be allowed a reasonable amount of time to undertake any necessary restructuring.

# Non-cooperation

- 5.1 The Group submits that a determination that a taxpayer is non-cooperative will not only have particular adverse consequences for the taxpayer under the proposed reforms, but could also have significant reputational consequences for the taxpayer. A taxpayer subject to disclosure obligations in connection with listed securities might for example (depending on the circumstances) be obliged to make public disclosure of any determination by Inland Revenue that it is non-cooperative. Given those consequences, there should be a clear statutory definition of non-cooperation as well as procedural safeguards in respect of such determination.
- 5.2 The statutory definition should state that a taxpayer is not non-cooperative merely because the taxpayer exercises its rights to dispute Inland Revenue's position or contest any steps Inland Revenue may take in an investigation. If a taxpayer were effectively subjected to detrimental consequences (in the form of a determination that the taxpayer is non-cooperative) as a consequence of contesting the validity of Inland Revenue's actions, then on the face of it the measure could be inconsistent with section 27(3) of the New Zealand Bill of Rights Act 1990 which provides that a person has the right to bring civil proceedings against, and to defend civil proceedings brought by, the Crown in the same way as civil proceedings between individuals.
- 5.3 In addition, there should be guidelines (in the form of a Standard Practice Statement) as to the process for determining that a taxpayer is non-cooperative. The power to make such a determination should rest with a relatively small number of senior officials within Inland Revenue, and any official making such a determination should



be independent from the personnel auditing/investigating or otherwise engaged with the taxpayer.

- 5.4 The statutory definition of non-cooperation and/or the Standard Practice Statement guidelines should also require advance written warning to be given prior to Inland Revenue determining that a taxpayer is non-cooperative. The taxpayer should receive written notice specifying the acts or omissions that Inland Revenue considers make the taxpayer uncooperative and affording the taxpayer a reasonable opportunity to respond to the warning and/or to remedy the actions or inactions that Inland Revenue considers may result in the taxpayer being uncooperative.
- 5.5 Finally, a taxpayer should have the right to apply to court to challenge any decision of Inland Revenue to deem it non-cooperative. As noted above, there could be significant reputational damage from being deemed "non-cooperative" and it is important that taxpayers have a means of effectively challenging such a determination.

# Advance payment of tax in dispute

- 5.6 The Group considers that the proposal that taxpayers in certain cases be required to pay tax in dispute prior to determination of the dispute is unjustified. The proposal is unjustified for a number of reasons:
  - The proposed rule is arbitrary, covering only disputes in relation to transfer pricing, the application of the source rules and tax payable under a double tax agreement ("DTA"). There is nothing special about these types of disputes to warrant the proposed rule;
  - The general rule that disputed tax be payable only following final determination of any dispute should remain, except in cases where there is a risk of non-payment of tax found owing. In cases in which there is a risk of non-payment of tax ultimately found to be owing, Inland Revenue already has the power (see section 138I of the TAA) to require early payment;
  - Multinational corporate taxpayers are not currently incentivised to delay resolution of disputes (as suggested at paragraph 6.21 of the Discussion Document) given the imposition of use of money interest at rates materially higher than commercial rates. While the ability to use tax pooling mitigates to some extent the effect of use of money interest being imposed at uncommercial rates, it does not eliminate it since the use of pooling involves its own costs;
  - The Government has not provided evidence in the Discussion Document of any practice of multinational groups not paying the required tax found owing at the conclusion of a dispute. To the extent there is in a particular case a perceived risk of that occurring, Inland Revenue has the power to require advance payment as noted above; and
  - Officials have suggested this measure is necessary to incentivise taxpayers to progress the dispute and resolve the matter. The Group challenges this suggestion. It is not appropriate for the time bar to be extended but then have taxpayers pay disputed tax earlier. Forcing a taxpayer to pay tax earlier (even if repayable at a later date) merely speeds up taxpayer 'burnout'.
- 5.7 The Group does not support the restriction on the use of tax pooling for disputes involving transfer pricing, the application of the source rules or tax payable under a

DTA. There appears to be no justification for tax pooling not being available in those cases. The tax pooling rules help mitigate the penal effect of use of money interest on underpaid tax applying at non-commercial rates for many taxpayers. The Discussion Document offers no justification as to why tax pooling should not be available. In the Group's view, tax pooling is a useful mechanism that allows some flexibility in situations where a taxpayer's exact liability is uncertain.

5.8 If this proposal does proceed the Group submits that a court order should be required to compel the earlier payment of tax in dispute. This will ensure that Inland Revenue does not require tax to be paid in advance of a dispute being resolved unless there is good reason to depart from the general rule that disputed tax should not be payable until it has been determined (or the taxpayer has accepted) that the disputed tax is in fact payable.

#### Collection of tax

- 5.9 The discussion document proposes allowing Inland Revenue to collect tax payable by a member of a large multinational group (as defined in the discussion document) from "any wholly owned subsidiary of the multinational in New Zealand". The proposed rule would also allow Inland Revenue to collect from a related New Zealand entity, tax on income attributed to a deemed PE of a non-resident. The discussion document states that such measures will "assist New Zealand in recovering tax payable by non-residents".
- 5.10 The Group is unaware of any existing difficulty arising from members of a multinational group not paying tax which is due and payable. The discussion document does not suggest there is (or provide any evidence of) any problem under existing law. The Group would be interested to understand the extent of any existing problem with multinational organisations not paying tax which is due and payable. The Group is sceptical that this is a real issue needing resolution, particularly when considering the relative size of these multinationals. The Group is also concerned that if other countries adopt a similar approach, New Zealand headquartered multinationals would be subject to punitive and unsubstantiated tax bills from the jurisdictions they operate in.
- 5.11 The Group is also concerned about the financial reporting and other commercial implications of a rule that would override the usual rule that members of a group are not jointly and severally liable for each other's liabilities. A rule imposing such liability could result in financial reporting implications for New Zealand members of multinational groups (e.g. the question could arise as to whether a contingent liability must be recognised). Such a rule would also complicate any assessment of risk by prospective lenders to or purchasers of the New Zealand business, since they would be required to inquire into not only the tax position of the particular New Zealand entities but the tax position of the wider group of which they form part. Significant compliance and other deadweight costs could result, in circumstances where no clear problem definition underlying the proposed rule is articulated in the discussion document.
- 5.12 Inland Revenue already has the power to request assistance from other jurisdictions in the collection of tax (see Convention on Mutual Administrative Assistance in Tax Matters). Given New Zealand's commitment to international cooperation in addressing BEPS, it is inappropriate for New Zealand to pursue a unilateral measure that cuts across an important internationally accepted norm of corporate law (that tax payable is payable by the particular company assessed, and is not subject to (in effect) a statutorily mandated guarantee by other members of the same group).

5.13 Finally, if the proposed rule does proceed, the Group submits that Inland Revenue should be required to obtain a court order to collect tax from an entity other than the entity against which it was assessed. The proposed rule is (for the reasons noted above) a significant departure from legal norms respecting the distinct and separate legal nature of individual entities, and as such should be subject to judicial oversight in its application.

#### Collection of information

The proposed power is unnecessary and has been rejected previously

- 5.14 The Group does not support the introduction of a power for Inland Revenue to make a New Zealand entity legally responsible for providing information that Inland Revenue may believe is held by another member of the multinational group. The TAA already provides that a person may be required to (and may commit an offence for omitting to) provide information held by foreign entities which that person controls. The discussion document proposes that the offence provisions in section 143 of the TAA be amended such that the New Zealand entity (a New Zealand resident or a New Zealand PE of a non-resident company) could be convicted of an offence for failing to provide information held by foreign associated persons of the New Zealand entity.
- 5.15 If the proposal proceeds, it would no longer be a defence under this offence provision that the New Zealand entity does not have possession or control of the information itself or over the entity that does hold the information. The New Zealand entity could therefore be convicted of an offence for acts or omissions of related entities which it does not control and in some cases cannot influence.
- 5.16 The Group notes that a similar provision was proposed in the Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill 2002. In that Bill, it was proposed that the Commissioner would have the power to request information from any persons "associated with the New Zealand resident". This proposal would have resulted in a New Zealand resident taxpayer being required to produce to Inland Revenue information held by non-resident entities related to the taxpayer, even if the taxpayer has no practical control over those entities, and in circumstances where the entities have no bearing on the taxpayer's New Zealand tax obligations (essentially the rule proposed in the discussion document).
- 5.17 After submissions were received on the Bill, Inland Revenue accepted that the application of the rule should be restricted to apply only to foreign entities controlled by a New Zealand resident.<sup>9</sup> This narrowed rule was subsequently enacted.

The Australian and Canadian provisions referred to in the discussion document are not comparable to what the discussion document proposes

5.18 The discussion document (at paragraph 6.34) states that the proposed change would align New Zealand law with Australian and Canadian law and refers to section 264A of the Income Tax Assessment Act 1936 (Cth) and section 231.6 of the Income Tax Act RS C 1985 c 1. The Australian and Canadian provisions have very different consequences from what the Discussion Document proposes for New Zealand however.

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<sup>8</sup> Clause 75

<sup>&</sup>lt;sup>9</sup> See Inland Revenue *Taxation* (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill: Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill ((November 2002) at 110.

5.19 Failure to comply with section 264A of the Income Tax Assessment Act 1936 (Cth) is not an offence. Section 264A(22) provides that:

A refusal or failure to comply with a request set out in an offshore information notice is not an offence.

5.20 The Australian Master Tax Guide states that:10

[t]he only sanction for failure to comply with a notice is evidentiary, ie the information or documents which the taxpayer fails to provide will not be admissible in subsequent proceedings disputing the taxpayer's assessment.

- 5.21 The consequence of not complying with the Australian rule reflects the purpose and nature of the rule. Fundamentally, it is an information gathering power to assist the Commissioner to assess the tax liability of the taxpayer, when that information is held offshore. But unlike the general power to request information (such as in section 17 of the TAA in the New Zealand context) section 264A is obviously directed at the particular risk to the Commissioner of offshore information not being provided during an investigation and then selectively used in proceedings to dispute an assessment. The only consequence of not providing that information is that the taxpayer is not able to use that information to dispute any assessment. The Group also notes that the decision of the Australian Commissioner to issue an offshore information notice is amendable to judicial review (including as to the form and content of the notice itself). 12
- 5.22 The Canadian provisions in section 231.6 of the Income Tax Act RS C 1985 c 1 specifically set out the right for the taxpayer to apply to a Judge for a review of the request for foreign based information or documentation.<sup>13</sup> The Judge then has the power to:
  - (a) confirm the requirement;
  - (b) vary the requirement as the judge considers appropriate in the circumstances; or
  - (c) set aside the requirement if the judge is satisfied that the requirement is unreasonable.
- 5.23 Section 231.6(6) then provides: 14

[f]or the purposes of paragraph 231.6(5)(c), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.

Michael Chow (ed) Australian Master Tax Guide (56th ed, CCH Australia Limited, Sydney, 2015) at [21-2201.

<sup>11</sup> FH Faulding and Co Ltd v the Commissioner of Taxation of the Commonwealth of Australia [1994] FCA 1492; (1994) 54 FCR 75 at [30].

FH Faulding and Co Ltd v the Commissioner of Taxation of the Commonwealth of Australia at [34].

<sup>&</sup>lt;sup>13</sup> Income Tax Act RS C 1985 c 1, s 231.6(5).

<sup>&</sup>lt;sup>14</sup> Income Tax Act RS C 1985 c 1, s 231.6(6).



- 5.24 Case law has clarified that even if the person holding the information is related to the taxpayer, that will not in itself make the request a reasonable one. <sup>15</sup> That is, even if the information is held by a related party, there is a protection for the taxpayer in that the request must still be reasonable in the circumstances.
- 5.25 The penalty for not complying with the request is the prohibition, on the motion of the Minister, on introducing any foreign-based information or document covered by the request which was not complied with. Only on conviction by the court is the taxpayer liable to a fine or term of imprisonment for not complying with the information request. The maximum penalty is a fine of \$25,000 and a term of imprisonment of no more than 12 months.

Inland Revenue can and should use existing powers

5.26 The discussion document acknowledges that Inland Revenue can and does seek information held by foreign entities using its exchange of information rights, but suggests that this is inadequate (at paragraph 6.32):

Recent improvements to the exchange of information between tax authorities are making it easier for Inland Revenue to request and exchange information that is held by offshore tax authorities. However, relying on an ability to request information indirectly from other tax authorities is not always adequate. In some cases, the relevant information is not held by the offshore tax authority and in other cases the foreign tax authority may be slow or unhelpful in responding to reasonable requests for information.

- 5.27 The first aspect of this justification (that the foreign tax authority may not hold the information) is not compelling. DTA partners can, and do, exercise their own information-gathering powers to obtain the information that Inland Revenue requests under the DTA, just as Inland Revenue exercises its powers to obtain information requested by our DTA partners.
- 5.28 It is difficult to evaluate the second aspect of the justification (that the foreign tax authority may be slow or unhelpful in responding) without knowing how common this is. It is to be hoped that this is not often the case given that the DTA or Tax Information Exchange Agreement (as applicable) imposes an obligation on the foreign Government to comply with a valid request, and that New Zealand (presumably) complies with its obligations under the DTA or TIEA.
- 5.29 But to the extent Inland Revenue might sometimes encounter difficulties or delays in obtaining information from a foreign revenue authority, New Zealand companies may be in no better position yet (under the proposed rule) would be at risk of criminal sanctions and / or a significant monetary penalty if the information is not provided. For the New Zealand company, it is not simply a matter of requesting the information from (or forwarding on Inland Revenue's information request to) the relevant foreign affiliates and expecting that the information will be provided. The practical difficulties include:<sup>18</sup>

See Fidelity Investment Canada Ltd v Canada (Revenue Agency) 2006 FC 551 and Soft-Moc Inc v Canada (National Revenue) 2013 FC 291.

<sup>&</sup>lt;sup>16</sup> Income Tax Act RS C 1985 c 1, s 231.6(8).

<sup>&</sup>lt;sup>17</sup> Income Tax Act RS C 1985 c 1, s 238(1).

For these same reasons, the Group is concerned that a New Zealand company's inability to provide information held by an associated foreign entity may be grounds to deem a taxpayer "non-cooperative". In fact, the non-provision of the information may be due to these very real practical constraints, and not to any desire to be uncooperative.



- Multinational groups may have hundreds or more legal entities operating in a large number of countries. If Inland Revenue were to have the power to issue an information request applicable to the whole group, it may be difficult or impossible for the New Zealand subsidiary to know even which legal entities may hold the information requested (and in which countries to make inquiries).
- Inland Revenue information requests are often very broadly worded, and may call for the production of large numbers (not infrequently thousands) of emails and other documents, which in turn could necessitate the review of an even greater number of documents to determine which are within the scope of the request. For such requests to apply not only to the New Zealand group but also to foreign associated persons could make the requests so costly and burdensome to comply with that compliance is for all practical purposes impossible.
- The New Zealand company will usually have no legal right to require a foreign associate to provide information to it. And even if the foreign associate is willing (in the interests of the group) to devote the time and resources necessary to assist the New Zealand company in locating and providing relevant documents, the foreign associate will need to consider whether it is appropriate to do so. For example, some of the information may be legally privileged. Local privacy and confidentiality laws will need to be considered.<sup>19</sup>

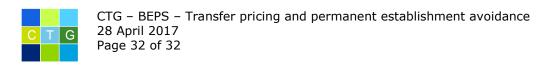
Alternative submission: if the proposal proceeds, judicial oversight is necessary

- 5.30 If the proposed rule were to proceed, Inland Revenue should be required to obtain a court order to impose on the New Zealand entity or person liability for non-provision of such information. This would provide judicial oversight in respect of the breadth of the request and feasibility of complying with it, and as to whether the need for such an onerous power to be exercised is justified in the circumstances.
- 5.31 In addition, the Group submits that if Inland Revenue is empowered to collect more information, this information can only be requested if it meets a "necessary and relevant" test. In the Group's view there needs to be a limit on the information that Inland Revenue can collect, especially where undue compliance costs are required to collect information that is not actually that important to the situation. In the Group's view, at the time information is requested, Inland Revenue should provide context as to why it is collecting information and how it is relevant to the taxpayer's New Zealand tax liability.

## Penalties for not providing information

5.32 The Group submits that it is not appropriate for Inland Revenue to have the power to impose a \$100,000 penalty on taxpayers who fail to comply with section 17 or section 21. A power to impose such a penalty should be left to the courts. This is especially so when taxpayers could be subject to penalties when information is not provided by a member of the same multinational group but over which the taxpayer may have no control.

These considerations were behind the need for FATCA to be implemented through Intergovernmental Agreements, such as that concluded between New Zealand and the United States. Had New Zealand financial institutions agreed to provide information directly to the United States (pursuant to an agreement with the United States Government under section 1471 of the Internal Revenue Code) they may have been in breach of their implied contractual obligation of confidentiality and/or their obligations under the Privacy Act 1993. For them to disclose the information to another Government to avoid a financial detriment (FATCA withholding) may not have been recognised as falling within the disclosure under compulsion of law exceptions to their confidentiality and Privacy Act obligations.



5.33 In the alternative, if Inland Revenue is given the power to impose what is effectively a \$100,000 instant fine (without first taking proceedings), taxpayers must have the right to apply to the court seeking that the penalty be reduced or set aside. This is necessary as a minimum in order to meet the requirements of section 27 of the New Zealand Bill of Rights Act 1990.

Section 21 in any event should be rewritten or repealed

- 5.34 Section 21 of the TAA needs to be reviewed, and at a minimum rewritten (regardless of whether its scope is broadened to include situations of non-inclusion of income as suggested by the discussion document). Alternatively, section 21 should be repealed. Inland Revenue already has the power to request information under section 17 of the TAA and non-compliance with section 17 is an offence. Section 21 is arbitrary in its application (e.g. it is triggered by the non-response to an information request after 90 days without regard to whether that time-frame is reasonable in the circumstances) and is disproportionate in its consequences (in denying a taxpayer access to the courts to contest the correctness of Inland Revenue's assessment).
- 5.35 Denying a taxpayer access to the courts (and preventing a taxpayer from contesting the correctness of Inland Revenue's assessment) is an arbitrary and potentially disproportionate consequence of not responding to an information request. It is also inconsistent with section 27(3) of the New Zealand Bill of Rights Act 1990. At a minimum, this aspect of the section 21 should therefore be repealed. If a taxpayer does not comply with a request for information, the consequences should be the same as for non-compliance with section 17 and/or that information that should have been furnished in response to the request and is not cannot subsequently be used in proceedings. The consequence should not be the denial of dispute rights in respect of the relevant assessment.

# Application dates for any Chapter 6 (administrative measures) proposals that do proceed

- 5.36 To the extent any of the Chapter 6 (administrative measures) proposals proceed, they should not apply from the date of enactment. The amendments would result in significant departures from legal norms and adversely affect the legal rights of taxpayers. Certain amendments could impose liability for tax, or, in respect of the obligation to provide information, on different legal entities solely because they are members of the same group.
- 5.37 The Group submits that there should be grandparenting of all existing arrangements at the time of enactment, with a five year sunset clause. A five year time period would provide a reasonable amount of time for multinationals to renegotiate agreements; noting that there will be many agreements within a single multinational which will need to be amended.
- 5.38 In the alternative, if a sunset clause as described above is not accepted, the proposals to the extent they proceed should apply only in respect of income years for which a tax position is taken after the date of enactment. In the Group's view, there should be a lead time of at least one year after the date of enactment before the amendments take effect.
- 5.39 As taxpayers have experienced from the recent enactment of the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 on 30 March 2017, having only 2 days lead in time before the next income year starts does not give taxpayers adequate lead in time.