

Sensitive

Office of the Minister of Revenue

Chair, Cabinet External Relations and Security Committee

AMENDING PROTOCOLS TO TAX TREATIES WITH SWITZERLAND AND GUERNSEY: APPROVAL FOR SIGNATURE

Proposal

1. This paper proposes that Cabinet authorises New Zealand's signature of, and the steps necessary to bring into force, the following international agreements:
 - 1.1 the *Protocol Amending the Convention between New Zealand and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income* ("the Amending Protocol with Switzerland"); and
 - 1.2 the *Protocol Amending the Agreement between the Government of New Zealand and the States of Guernsey for the Exchange of Information with Respect to Taxes and the Allocation of Taxing Rights with Respect to Certain Income of Individuals* ("the Amending Protocol with Guernsey").

Executive Summary

2. Officials have concluded negotiations for protocols to amend New Zealand's existing double tax agreement (DTA) with Switzerland, which was signed in 1980, and existing tax information exchange agreement (TIEA) with Guernsey, which was signed in 2009. The protocols relate to the inclusion of model treaty provisions in the parent agreements arising out of the international Base Erosion and Profit Shifting (BEPS) initiative, led by the Organisation for Economic Co-operation and Development (OECD) and the G20. The BEPS initiative consisted of a 15-point Action Plan, designed to address international concerns that multinationals often seem to pay little or no tax anywhere in the world. Several items on the BEPS Action Plan resulted in the development of model treaty provisions to be included in future and existing tax treaties – in particular, anti-abuse provisions, arising from Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), and provisions to improve treaty dispute resolution mechanisms, arising from Action 14 (Making Dispute Resolution Mechanisms More Effective). Many of these provisions are referred to as "minimum standards", and their adoption will be monitored by an international peer review process.
3. To facilitate the inclusion of these model treaty provisions in existing DTAs, Action 15 of the BEPS Action Plan focused on the development of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Multilateral Instrument, or MLI), which New Zealand signed in 2017 and ratified in 2018.
4. A few of New Zealand's DTAs will not be amended by the MLI, and tax treaties that are not full DTAs are outside the scope of the MLI. Where this is the case, bilateral negotiations will need to be undertaken in order to meet the appropriate minimum

standards. The protocols with Switzerland and Guernsey have been negotiated for this purpose.

5. This paper seeks Cabinet's approval for the two protocols to be signed. The full text of each protocol is appended to this paper as Annexes I and II. This paper also seeks approval of an extended national interest analysis (NIA) prepared for each agreement. The extended NIAs will help guide Cabinet consideration and, after signing, will also be present in the House when the protocols are submitted for parliamentary treaty examination. The extended NIAs are attached as Annexes III and IV.
6. After treaty examination, each protocol will be given the force of law in New Zealand by Order in Council, made pursuant to section BH 1 of the Income Tax Act 2007. This paper seeks Cabinet approval for me to instruct the Parliamentary Counsel Office to draft the respective Orders in Council. Finally, this paper seeks approval for officials to bring the protocols into force through an exchange of diplomatic notes with Switzerland and Guernsey.

Comment

7. This paper submits, for Cabinet's consideration, two recently concluded protocols and an extended national interest analysis (NIA) for each. This paper seeks approval for the protocols to be signed, and approval for the next steps for entry into force. The two protocols are:
 - 7.1 the *Protocol Amending the Convention between New Zealand and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income* ("Amending Protocol with Switzerland"); and
 - 7.2 the *Protocol Amending the Agreement between the Government of New Zealand and the States of Guernsey for the Exchange of Information with Respect to Taxes and the Allocation of Taxing Rights with Respect to Certain Income of Individuals* ("Amending Protocol with Guernsey").
8. The full text of the Amending Protocol with Switzerland is appended to this paper as Annex I. The full text of the Amending Protocol with Guernsey is appended as Annex II. The accompanying extended NIAs are appended, respectively, as Annexes III and IV.
9. The protocols have both been negotiated as part of New Zealand's programme of updating existing tax agreements to include model treaty provisions arising out of the recent international work on Base Erosion and Profit Shifting (BEPS). The Amending Protocol with Switzerland amends New Zealand's 1980 double tax agreement (DTA) with Switzerland (the Swiss DTA). The Amending Protocol with Guernsey amends New Zealand's 2009 tax information exchange agreement (TIEA) with Guernsey (the Guernsey TIEA).

Tax treaty background

10. DTAs are bilateral international treaties designed to foster economic relations between countries by reducing tax impediments to trade, investment, and other cross-border economic activity. More specifically, DTAs aid taxpayers by providing greater certainty of tax treatment, eliminating double taxation, reducing withholding taxes on cross-border investment returns, and exempting certain short-term activities in the host state from income tax.
11. DTAs also enable the tax administrations of the treaty countries to assist each other in the detection and prevention of tax avoidance and evasion by establishing a mechanism for exchanging information. New Zealand currently has 40 DTAs in force.
12. Tax information exchange agreements (TIEAs) are bilateral international treaties that are only designed to enable the tax administrations of the treaty countries to assist each other in the detection and prevention of tax avoidance and evasion. TIEAs do this by establishing a mechanism for exchanging information. TIEAs authorise tax assistance with jurisdictions with whom a full DTA may not be appropriate, such as low-tax jurisdictions. New Zealand currently has 19 TIEAs in force.
13. Many TIEAs are accompanied by supplementary agreements, which include a limited selection of DTA articles and are known as limited-scope DTAs. The TIEA with Guernsey is a limited-scope DTA but includes the limited selection of additional DTA Articles within the TIEA itself, rather than in a separate agreement.
14. The selection of DTA articles included in the Guernsey TIEA provide for the allocation of taxing rights in respect of government service and students, and establish a dispute resolution mechanism for transfer pricing adjustments.

Base Erosion and Profit Shifting

15. The international Base Erosion and Profit Shifting (BEPS) initiative, led by the Organisation for Economic Co-operation and Development (OECD) and the G20, has been a global focus since 2013. The BEPS initiative arose from international concerns that multinationals often seem able to not pay tax anywhere in the world. The G20 and the OECD initiated work to identify the mechanisms and techniques being used, and to formulate appropriate multilateral and bilateral responses.
16. This work led to the development of the BEPS 15-point Action Plan. Due to the global nature of BEPS, an international forum (the BEPS Inclusive Framework) was established to undertake this work. The BEPS Inclusive Framework currently has 129 members, including New Zealand.
17. The BEPS Action Plan included several work streams that looked into the ways that multinational enterprises have misused tax treaties. Action 6 focused on the granting of treaty benefits in inappropriate circumstances, and developed model treaty anti-abuse provisions. Action 14 focused on ways to make treaty dispute resolution mechanisms more effective, as anti-abuse provisions can increase uncertainty for taxpayers and investors.

18. The model treaty provisions that emerged from the BEPS work were formally included in the OECD and United Nations Model Tax Conventions (on which almost all DTAs worldwide are based) in their respective 2017 updates.
19. Some of these model provisions constitute “minimum standards” that all members of the BEPS Inclusive Framework are required to include in their tax treaties. The implementation of these minimum standards in tax treaties is being monitored and assessed through an OECD-led international peer review process. The peer review for the Action 6 minimum standards will only monitor implementation of the standards in full DTAs. Most of the Action 14 minimum standards apply to both full DTAs and limited-scope DTAs.
20. Model treaty provisions that are not minimum standards are referred to as “best practice”, and their inclusion in treaties will not be peer reviewed. New Zealand will only be able to include these best practice provisions to the extent that the other jurisdiction concerned agrees to include them.
21. To facilitate the inclusion of these model treaty provisions in existing DTAs without the need for thousands of bilateral negotiations, Action 15 of the BEPS Action Plan focused on the development of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Multilateral Instrument, or MLI), which New Zealand signed in 2017 and ratified in 2018. As of 9 April 2019, the MLI had been signed by 87 jurisdictions and ratified by 25 signatories, including New Zealand.
22. When two parties to an existing bilateral DTA sign the MLI and both include the DTA in their respective lists of treaties to be covered by the MLI, the DTA will be updated to include the BEPS model treaty provisions. The update must include all of the minimum standards, but either party can choose to include some or none of the best practice provisions, which will only be included where both parties have done so.
23. At this stage, 30 of New Zealand’s 40 DTAs will be updated by the MLI. With Switzerland, differences in our respective legal structures require our DTA to be updated bilaterally rather than through the MLI. The Guernsey TIEA will not be updated because the MLI only applies to full DTAs, and not limited-scope DTAs or TIEAs. Inland Revenue has therefore already negotiated bilateral protocols with these jurisdictions. Other bilateral negotiations will also be required, but the actual number is yet to be determined.
24. The protocols that have been negotiated with Switzerland and Guernsey relate to the inclusion of the BEPS minimum standards, and some of the best practice provisions. If needed, more detailed information on the specific changes made to the parent agreement by each protocol is set out in an Appendix at the end of this paper. The extended NIAs attached in Annexes III and IV also contain additional detail.
25. Given the limited application of the existing TIEA with Guernsey to certain income derived by students and government employees, the direct impact of the Amending Protocol with Guernsey is expected to be small, as the existing TIEA provides very little scope for treaty abuse. The main advantages of the Amending Protocol with Guernsey will be to assist in maintaining New Zealand’s reputation in the international tax community and build a precedent for future tax treaty negotiations.

Next steps

26. In addition to seeking Cabinet approval for the two protocols to be signed, this paper also seeks approval for the necessary steps to be taken to bring each protocol into force after it has been signed. This will involve:
 - 26.1 *Parliamentary treaty examination.* Pursuant to previous Cabinet decisions as to the application of Standing Orders 397-400 to DTAs, all DTAs, limited-scope DTAs, TIEAs, and protocols that amend these agreements must undergo parliamentary treaty examination. Each protocol and its associated extended NIA will therefore need to be present in the House for consideration by Select Committee.
 - 26.2 *An Order in Council.* After treaty examination is complete, and pursuant to section BH 1 of the Income Tax Act 2007, each protocol will be given the force of law in New Zealand by Order in Council.
 - 26.3 *Exchange of diplomatic notes.* After the completion of the previous steps, and pursuant to requirements set out in the Entry into Force Article of each protocol, diplomatic notes will be exchanged with Switzerland and Guernsey, respectively. This will bring each protocol into force.

Consultation

27. The Ministry of Foreign Affairs and Trade, and the Treasury, were consulted in the preparation of this Cabinet paper. The extended NIAs were prepared by Inland Revenue in consultation with the Ministry of Foreign Affairs and Trade, and the Treasury.
28. The BEPS measures arose from an international process which involved considerable private-sector consultation. No additional private-sector consultation was entered into in the preparation of this paper. Consistent with international practice, officials generally do not consult on the content of tax treaties. As the protocols with Switzerland and Guernsey follow international decisions made in the course of the BEPS work, and New Zealand's signing and ratification of the MLI, the contents of the Amending Protocols are unlikely to be unexpected.

Financial Implications

29. The BEPS model treaty provisions are primarily intended to protect the tax base of each treaty partner, by reducing the ability of non-residents investing or operating in a jurisdiction to use the treaty to engage in tax avoidance behaviour. Overall, this will have a positive impact on tax revenue in New Zealand, particularly as the provisions start to take effect across New Zealand's treaty network. The provisions are reciprocal, so the amount of foreign income tax paid by New Zealand taxpayers may increase if they are engaging in BEPS behaviour overseas. This would reduce the amount of tax paid in New Zealand through increased foreign tax credits.
30. Data limitations mean that the specific impact for Switzerland cannot be quantified, although it is expected to be small, albeit positive, because New Zealand is a net capital importer. In the year to March 2018, total New Zealand investment in Switzerland was approximately \$246 million, while total Swiss investment in New Zealand was \$2,290 million. Breaking this down into direct investment, there was

\$621 million of Swiss direct investment in New Zealand, and negligible direct investment by New Zealand investors in Switzerland (Statistics New Zealand).

31. The specific impact of the Guernsey TIEA is also unquantifiable, but will be negligible. This is because the Guernsey TIEA has limited application to certain government employees and students, but not businesses or investors. It is therefore unlikely that the Guernsey TIEA could be used to facilitate BEPS, even without the inclusion of the new provisions.
32. The model dispute resolution provisions complement the treaty-abuse provisions by improving the dispute resolution mechanisms available to taxpayers and investors. This is to reduce uncertainty arising from the new provisions. Inland Revenue will face increased costs in administering the updated dispute resolution provisions under both Amending Protocols. However, these costs will be marginal and will be absorbed within existing funding baselines.
33. The proposed changes will not fundamentally alter the existing dispute resolution mechanisms, but will improve access to them. For Guernsey, government employees and students affected by the TIEA will be able to access the standard dispute resolution mechanism under the TIEA, which they are currently unable to do. In the case of Switzerland, the costs may be slightly higher, as arbitration will be available to taxpayers if the two authorities are unable to resolve a dispute within three years. However, New Zealand's experience is that arbitration very rarely needs to be invoked, as it creates an incentive for tax authorities to come to an agreement in a timely manner.

Legislative Implications

34. As is usual practice for tax treaties, the protocols will each be given effect by Order in Council made pursuant to section BH 1 of the Income Tax Act 2007. Once in force, each protocol will then override specified domestic legislation (the Inland Revenue Acts, the Official Information Act 1982, and the Privacy Act 1993). The override only applies in respect of tax.
35. Each Order in Council will be submitted to Cabinet following the signing of the respective protocol and the successful completion of parliamentary treaty examination.

Impact Analysis

36. As the proposal has regulatory implications (the protocols each require an Order in Council), Cabinet's Impact Analysis Requirements apply. However, as this paper relates to international treaties for which extended NIAs have been prepared (see Annexes III and IV), separate Regulatory Impact Statements are not required. The NIAs substitute for Regulatory Impact Assessments.
37. The Quality Assurance reviewer at Inland Revenue has reviewed the extended NIAs *Protocol to amend Double Tax Agreement with Switzerland* and *Protocol to amend Tax Information Exchange Agreement with Guernsey* prepared by Inland Revenue and considers that it meets the quality assurance criteria of the Regulatory Impact Analysis framework.

Human Rights

38. No inconsistencies with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993 have been identified.

Publicity

39. The text of each protocol will be made available on Inland Revenue's tax policy website after it has been signed. The extended NIAs will be publicly available on the Parliament website following parliamentary treaty examination. Appropriate media statements and announcements will be made at key steps during the entry into force process.

Proactive Release

40. I propose to delay the proactive release of this paper until the appropriate signatures have been obtained, and Switzerland and Guernsey have agreed to the release. The release will be subject to redaction as appropriate under the Official Information Act 1982.

Recommendations

The Minister of Revenue recommends that the Cabinet External Relations and Security Committee:

1. **note** that, to ensure the underlying agreements meet minimum international standards relating to base erosion and profit shifting, officials have negotiated:
 - 1.1 *Protocol Amending the Convention between New Zealand and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income* (Amending Protocol with Switzerland), attached as Annex I;
 - 1.2 *Protocol Amending the Agreement between the Government of New Zealand and the States of Guernsey for the Exchange of Information with Respect to Taxes and the Allocation of Taxing Rights with Respect to Certain Income of Individuals* (Amending Protocol with Guernsey), attached as Annex II;
2. **approve** the text of each Amending Protocol, subject to any minor or technical changes arising from the process of legal verification;
3. **agree** that New Zealand signs each Amending Protocol;
4. **approve** the extended National Interest Analyses (NIAs) prepared in relation to each of the Amending Protocols, attached as Annexes III and IV;
5. **note** that, following signature, the texts of each Amending Protocol and its accompanying extended NIA will be presented to the House of Representatives for parliamentary treaty examination, in accordance with Standing Orders 397-400;
6. **note** that the Amending Protocols will each be incorporated into New Zealand domestic law through an Order in Council, pursuant to section BH 1 of the Income Tax Act 2007;
7. **invite** the Minister of Revenue to instruct the Parliamentary Counsel Office to draft the Orders in Council to give effect to the Amending Protocols;

8. **note** that, following the signing and satisfactory completion of parliamentary treaty examination, the Orders in Council will be submitted to Cabinet for approval;
9. **authorise** officials, following signature, satisfactory completion of parliamentary treaty examination and promulgation of the Orders in Council, to bring the Amending Protocols into force by exchanging diplomatic notes with Switzerland and Guernsey.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue

Switzerland

Minimum standards

1. Article I of the protocol updates the preamble of the Swiss DTA to clarify that the DTA intends to eliminate double taxation without creating opportunities for non-taxation or reduced taxation. This is important because preambles play an important role in treaty interpretation. For example, court cases on tax evasion and tax avoidance can turn to the preamble of a DTA to clarify the intention of the parties.
2. One of the minimum standards under Action 14 is for DTAs to require solutions reached under the mutual agreements procedure (MAP) to be implemented, notwithstanding any domestic time limits. However, as this may not be possible for all jurisdictions under domestic law settings, the minimum standard can be met in an alternative way (by imposing time limits on making adjustments). This is the case for Switzerland, and Articles II and III of the protocol reflect the alternative approach. They introduce a five-year limit beyond which the tax authorities may not adjust the profits attributable to associated enterprises or permanent establishments. As a safeguard, this restriction will not apply in the case of fraud, gross negligence, or wilful default. New Zealand tax legislation is already broadly consistent with this approach (by virtue of our four-year domestic time bar for making tax adjustments), so this provision will have little impact on New Zealand.
3. Article III also introduces a requirement that when a transfer pricing adjustment is made by one tax authority, the other tax authority is required to make a corresponding adjustment. This provision is intended to ensure that taxpayers are not double taxed on their profits. The provision has actually been in the OECD Model Tax Convention for several years and already features in most of New Zealand's DTAs, with the Swiss DTA being an exception.
4. Article V of the Amending Protocol will allow taxpayers to present a dispute resolution case to either tax authority. At present, the DTA requires a taxpayer to present their case to the tax authority of the jurisdiction where they are resident. This change is intended to provide flexibility for taxpayers.
5. Article VII introduces a "principal purpose test" (PPT) as new Article 25A into the Swiss DTA. The PPT operates by denying benefits if one of the principal purposes of an arrangement is to benefit from the DTA. The PPT is an important tool in the fight against BEPS, and reduces the risk that the DTA can be misused in abusive arrangements and transactions to eliminate tax in New Zealand.

Best practice provisions

6. Article IV of the Amending Protocol will update the provisions in the DTA that relate to the elimination of double taxation, to ensure that Switzerland is not required to provide an exemption from Swiss income tax for New Zealand-sourced income that was exempt from income tax or subject to a lower withholding rate because of the provisions of the DTA. The aim of this provision is to prevent double non-taxation

and is a recommendation arising from Action 2 of the BEPS Action Plan (Hybrid Mismatch Arrangements).

7. This provision only applies for Switzerland, because Switzerland uses the “exemption method” to relieve double taxation, whereas New Zealand uses the “credit method”. Under the credit method, New Zealand provides a foreign tax credit for foreign income tax paid to offset against the taxpayer’s New Zealand income tax liability, so the same risk of double non-taxation does not arise.
8. Articles VI and VIII of the Amending Protocol introduce arbitration provisions into the DTA, to support the existing MAP dispute-resolution mechanism. Under these provisions, if the two tax authorities are unable to resolve a MAP case within three years, the taxpayer concerned will be able to ask for the case to be submitted to arbitration. New Zealand already has arbitration in its DTAs with Australia (signed in 2009) and Japan (signed in 2012), and has signed up to arbitration under the MLI. Officials advise that the existence of arbitration provides a strong incentive for tax authorities to resolve issues under MAP before arbitration can be triggered. In practice, arbitration only needs to be invoked on extremely rare occasions and, to date, New Zealand has not yet had a case.
9. Arbitration is not available if a decision has already been rendered by a court or administrative tribunal, or in cases involving the application of New Zealand’s general anti-avoidance rule (Section BG 1 of the Income Tax Act 2007), permanent establishment anti-avoidance rule (Section GB 54 of the Income Tax Act 2007), or in specified circumstances in which hard-to-value intangibles are involved.

Guernsey

Minimum standards

10. The Action 14 minimum standards on dispute resolution are required for limited-scope DTAs. The TIEA with Guernsey was identified as a deficiency in New Zealand’s treaty network when the first-stage peer review for Action 14 was completed. Article 2 of the Amending Protocol therefore updates Article 11 (Mutual Agreement Procedure) of the TIEA to ensure that the agreement meets the Action 14 minimum standards. These changes are taxpayer-friendly measures.
11. MAP will no longer be limited to cases concerning transfer pricing adjustments. MAP will also be available in relation to the allocative Articles concerning the taxation of government service income and students, to ensure that New Zealand government employees or students based in Guernsey (and vice versa) will be able to present a case if they believe that they are not being taxed in accordance with the terms of the agreement.
12. As with the Amending Protocol with Switzerland, the Amending Protocol with Guernsey relaxes the requirement that the MAP case needs to be presented to the competent authority of the jurisdiction where the taxpayer concerned is tax resident. MAP will enable the taxpayer to present their case to either competent authority.
13. Finally, the Amending Protocol will require the competent authorities to implement any agreement arising out of the MAP, notwithstanding time limits in domestic law.

This ensures that tax authorities are unable to “run down the clock” on MAP cases and claim that they are unable to implement a MAP decision due to domestic time limits.

14. As noted, the TIEA with Guernsey is a limited-scope DTA. This means that the TIEA will not be subject to peer review under Action 6. This is because such agreements either do not have provisions that allocate taxing rights, or only allocate taxing rights in extremely limited circumstances (in the case of Guernsey, the TIEA only allocates taxing rights with respect to government employees and students). There is very limited scope for treaty abuse in such cases.
15. Nevertheless, members of the BEPS Inclusive Framework still need to satisfy the requirements of the minimum standard if requested by another Inclusive Framework member. Guernsey has requested the inclusion of the two Action 6 minimum standard provisions. The inclusion of these provisions is not necessary from a base protection perspective due to the limited application of the TIEA, but they will not be harmful.
16. Similar to the Amending Protocol with Switzerland, Article 1 of the Amending Protocol with Guernsey will update the preamble to the TIEA to clarify that the TIEA intends to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. Article 3 of the Amending Protocol introduces a new Article 11A into the TIEA to provide for a PPT, which operates by denying benefits if one of the principal purposes of an arrangement was to benefit from the agreement.

Protocol amending the Agreement between the Government of New Zealand and the States of Guernsey for the exchange of information with respect to taxes and the allocation of taxing rights with respect to certain income of individuals done at London on 21 July, 2009

Withheld under s 18(d) as the information is already publicly available.

National interest analysis: Protocol to amend Tax Information Exchange Agreement with Guernsey

Withheld under s 18(d) as the information is already publicly available or will be publicly available soon.

Protocol amending the Convention between New Zealand and the Swiss Confederation for the avoidance of double taxation with respect to taxes on income

Withheld under s 18(d) as the information is already publicly available.

National interest analysis: Protocol to amend Double Tax Agreement with Switzerland

Withheld under s 18(d) as the information is already publicly available or will be publicly available soon.