New Zealand House of Representatives
Te Whare Māngai o Aotearoa

Finance and Expenditure Committee
Komiti Whiriwhiri Take Pūtea, Take Whakapaunga Pūtea

54th Parliament
March 2024

International treaty examination of the second protocol to the agreement between New Zealand and the Republic of Austria with respect to taxes on income and on capital, done at Vienna on 21st September 2006

Presented to the House of Representatives
by Stuart Smith, Chairperson

Contents

Recommendation 3
Appendix A: Committee procedure 4
Appendix B: National Interest Analysis 5

Second Protocol to the Agreement between New Zealand and the Republic of Austria with Respect to Taxes on Income and on Capital, Done at Vienna on 21st September 2006

Recommendation

The Finance and Expenditure Committee has conducted the international treaty examination of the second protocol to the agreement between New Zealand and the Republic of Austria with respect to taxes on income and on capital, done at Vienna on 21st September 2006.

The committee has no matters to bring to the attention of the House and recommends that the House take note of its report.

Appendix A: Committee procedure

Committee procedure

This treaty was referred to us on 5 February 2024. We met between 14 February and 20 March 2024 to consider it. We received written evidence and heard oral evidence from the Inland Revenue Department.

Committee members

Stuart Smith (Chairperson)
Jamie Arbuckle
Hon Barbara Edmonds
Nancy Lu
David MacLeod
Hon Grant Robertson
Hon Dr Deborah Russell
Todd Stephenson
Chlöe Swarbrick
Rawiri Waititi
Catherine Wedd

Related resources

We received the following document as evidence for this international treaty examination. It is available on the Parliament website, along with a recording of our meeting on Wednesday, 6 March 2024.

- Letter from Inland Revenue (Cover notes for Austria tax treaty)

Appendix B: National Interest Analysis

National Interest Analysis

The National Interest Analysis, prepared by the Inland Revenue Department, is attached.

NATIONAL INTEREST ANALYSIS:
Second Protocol to the Agreement between New Zealand and the Republic of Austria with respect to Taxes on Income and on Capital

1. Executive summary

1.1 On 12 September 2023 New Zealand signed the *Second Protocol to the Agreement between New Zealand and the Republic of Austria with respect to Taxes on Income and on Capital* (*the Protocol*).

1.2 The Protocol is an amendment to New Zealand's double tax agreement (*DTA*) with Austria, the *Agreement between New Zealand and the Republic of Austria with respect to Taxes on Income and on Capital*, and its first Protocol, signed in Vienna on 21 September 2006 (collectively, the *Existing DTA*).

1.3 The Existing DTA is one of 40 New Zealand DTAs currently in force. DTAs are bilateral international treaties that are intended to encourage growth in economic ties between countries. They reduce or eliminate double taxation and other tax impediments to cross-border economic activity. In addition, DTAs ease some of the compliance costs and cash flow implications of such activity. They also provide a framework for greater certainty for businesses to make investment, and other cross-border decisions.

1.4 New Zealand engaged in Protocol negotiations with Austria to honour a most-favoured nation (*MFN*) obligation in the Existing DTA relating to withholding tax rates on investment income. Under the MFN obligation, New Zealand was required to enter into negotiations with Austria with a view to providing lower withholding rates on such income.

1.5 The Austrian MFN obligation was triggered back in 2010 when New Zealand agreed to reduce withholding rates with Australia and the United States. Since then, similar reductions have also been agreed in DTAs with Japan, Canada, Hong Kong and Singapore.

1.6 The background to these developments is that New Zealand, being a net capital importer, has historically kept DTA withholding tax rates high relative to the standards

of other countries in the Organisation for Economic Co-operation and Development (*OECD*). With dividends, however, the 15% withholding rate was offset by allowing tax credits for dividends paid out of fully taxed company profits ("fully imputed dividends"). In 2010, this regime was replaced for most fully imputed dividends by reducing our domestic withholding tax to 0%.

1.7 This followed a reduction in withholding rates in the DTAs mentioned above. Locking in lower DTA withholding rates provides foreign investors from these countries with greater certainty and secures reciprocity for New Zealand investors making foreign direct investments in those countries.

1.8 The withholding tax rate reduction agreed in the Protocol is that for dividends paid to an Austrian company that owns a substantial holding (at least 10%) in a New Zealand company (and vice-versa), and provided other conditions are met, the withholding tax rate will be reduced from 15% to either 5% or 0%. In all other cases the withholding rate of 15% on dividends in the Existing DTA will continue to apply.

1.9 The Protocol is not of itself expected to give rise to significant economic benefits of a general nature since Austria is not currently a key trading or investment partner. However, it is relevant to existing, substantial investment by Austria in the oil and gas exploration sector in New Zealand.

1.10 Another aspect of the Protocol relates to New Zealand's broader international relations. It confirms that New Zealand will honour its international commitments that arise when MFN obligations are triggered – which happens from time to time.

1.11 The Protocol is not expected to give rise to material fiscal costs. This is because a 0% rate already applies under domestic law to fully imputed dividends paid to a non-resident shareholder with a substantial holding of at least 10%. The Protocol would therefore only reduce rates for unimputed or partially imputed dividends, which will only arise in limited circumstances. Also, there was no change to the Existing DTA in respect of the withholding tax on royalties and interest.

1.12 In addition to negotiating the new withholding tax rates during the Protocol negotiations with Austria, the opportunity was also taken to update the Existing DTA in several other respects. One of those extra updates was to insert a package of new international model

anti-treaty abuse provisions that have been developed as part of the Base Erosion and Profit Shifting (*BEPS*) work undertaken by the OECD. These BEPS provisions are progressively being rolled out across New Zealand's DTAs. Their inclusion in the Existing DTA will help ensure that the DTA is not used to reduce taxation in unintended ways.

1.13 The Protocol will also insert into the Existing DTA a new Assistance in the Collection of Taxes Article, which will enable the two sides to request administrative assistance from each other in the collection of taxes in default. New Zealand now seeks the inclusion of this Article in all DTA negotiations.

1.14 Further, the Protocol will narrow the scope of the MFN obligation going forward so that it only applies in respect of New Zealand's DTAs with other European Union countries, rather than with other OECD countries. The other updates made by the Protocol are generally of a minor or administrative nature and for the most part will not affect taxpayers.

2. Nature and timing of the proposed treaty action

2.1 The Protocol was signed in Vienna on 12 September 2023, in the English and German languages, with both texts being equally authentic. In the case of divergence, the English text prevails. In accordance with the entry into force procedures specified in Article XVII of the Protocol, the date of entry into force will be the date of the later of the two diplomatic notes that will be exchanged. The Protocol will amend the Existing DTA once it enters into force. It is anticipated that this would occur in early February 2023.

2.2 The remaining preliminary steps required for New Zealand to be in a position to exchange diplomatic notes are (i) Parliamentary treaty examination of the Protocol and of this National Interest Analysis, under Standing Order 405, and (ii) giving the Protocol the force of law in New Zealand, which can be achieved by means of an Order in Council made under section BH 1 of the Income Tax Act 2007.

2.3 As for the Existing DTA, and for DTAs generally, the Protocol will not apply to the Cook Islands, Niue, or Tokelau.

3. Reasons for New Zealand becoming party to the treaty

General background

3.1 DTAs are bilateral international treaties that establish a framework for cooperation on tax matters between the treaty partners, with a view to reducing tax impediments to, and thereby helping to stimulate, increased trade, investment and other cross-border economic activity. The framework includes allocating taxing rights according to agreed international principles, mechanisms for reducing or eliminating double taxation, and an agreed reciprocal reduction of withholding taxes on investment returns.

3.2 The allocation of taxing rights and reduction of withholding tax rates means that New Zealand loses the ability to impose some tax that it otherwise could, and DTAs therefore reduce tax revenue. However, this reduction is offset by the reciprocal reduction of taxing rights over New Zealand residents in the treaty partner country, reducing the need for New Zealand to allow foreign tax credits.

3.3 Whether the net effect on tax revenue is an increase or decrease under this offset depends on flows of trade and investment. However, the main objective is for a DTA to foster wider indirect benefits, particularly in the form of increased trade, investment and other economic benefits, but on occasion also taking into account broader foreign policy considerations.

3.4 New Zealand began entering into DTAs in 1947, and currently has a network of 40 DTAs in force. This includes the Existing DTA with Austria signed in 2006. DTAs can be updated, either by means of an amending protocol or by renegotiating the entire DTA.

Honouring the Most Favoured Nation (MFN) Obligation

3.5 The main reason for agreeing the Protocol is to satisfy an MFN obligation applying to New Zealand in the Existing DTA. The MFN obligation provides that if New Zealand concludes a subsequent DTA with an OECD member country with withholding rates on dividends, interest or royalties that is less than the rates in the Existing DTA then New Zealand must negotiate with Austria - with a view to providing reduced rates to Austria. The primary focus of these negotiations was on the reduction of the withholding rate of 15% on dividends.

3.6 The OECD Model Tax Convention (*OECD Model*) provides an international blueprint for DTAs. The general dividend withholding rate proposed in the OECD Model is 15% but is lowered to 5% for dividends paid to a company directly holding at least 25% of the shares in the company paying the dividends. Prior to 2010, New Zealand did not have a DTA with withholding rates for dividends below 15%. To maintain the 15% rate, New Zealand sometimes agreed to include MFN obligations in its DTAs. The MFN obligation was included in the Existing DTA for this reason.

3.7 Since 2010, New Zealand has reduced its withholding rates on dividends and royalties with significant economic partners. New DTAs with Australia and the United States triggered the MFN obligation in the Existing DTA. DTAs entered into since then include Canada, Japan, Singapore and Hong Kong – albeit with a range of different negotiated outcomes depending on country preferences.

3.8 Austria is not a key trade and investment partner for New Zealand at present. Applying the new DTA policy to Austria is therefore unlikely to give rise to significant economic benefits for New Zealand. However, there is a substantial Austrian investment in the oil and gas sector in New Zealand.

3.9 Negotiations with Austria were prioritised, at Austria's request, to satisfy the MFN obligation that was triggered in 2010. Reducing the withholding rates in the Existing DTA is therefore a necessary consequence of agreeing the new low rates in DTAs with more significant economic partners.

3.10 Honouring the MFN obligation will enhance New Zealand's credibility in future DTA negotiations as a country that honours its international commitments. It will also support bilateral relations with Austria and will reflect well on New Zealand's general international reputation. This is particularly relevant at a time when New Zealand is seeking to expand its network of free trade agreements, which often include MFN clauses.

New Zealand's DTA policy on withholding tax on dividends

3.11 New Zealand's DTA policy on lowering withholding tax rates on dividends occurred in conjunction with changes made to its domestic tax settings.

3.12 Taxing dividends can result in double taxation because the company paying the dividend may have already paid income tax on its profits. New Zealand operates an imputation system, whereby companies receive imputation credits for tax paid at the company level. Companies can then attach imputation credits to dividends that they distribute, offsetting or reducing tax paid at the shareholder level. Fully imputed dividends are dividends paid out of profits that have been fully taxed at the company level. Withholding tax on dividends, particularly fully imputed dividends, can deter foreign investment and raise the cost of importing capital for New Zealand businesses. Due to concerns over difficulties in attracting foreign investment, in 2010, New Zealand reduced its domestic rate of non-resident withholding tax (*NRWT*) to 0% on fully imputed dividends from 'direct' investment, replacing the former tax credit regime for such investments. (Direct investment is where the shareholder owns at least 10% of the company paying the dividends.)

3.13 Around the same time, New Zealand renegotiated its treaties with its major trading partners, starting with the United States and Australia. The 15% dividend withholding rate was reduced to 5% or 0% in those treaties, provided certain conditions were met (for example, the shareholder must own a certain percentage of the company paying the dividend). The reduced dividend withholding rates had the following implications:

3.13.1 *Reciprocity for New Zealanders investing offshore*. As DTAs are bilateral, a reduced DTA withholding rate allows New Zealanders investing offshore to enjoy lower withholding rates in the other country. This also benefits New Zealand as it allows New Zealand to tax foreign dividends earned by New Zealand resident companies without having to provide tax credit for foreign tax paid in the other country.

3.13.2 *Unimputed dividends*. Under New Zealand's domestic law, NRWT continues to be imposed on unimputed dividends. But the reduced dividend withholding rates in DTAs do not require dividends to be fully imputed. Unimputed dividends can arise in legitimate circumstances. For example, the dividends may be paid out of untaxed capital gains instead of fully taxed profits, or a change in shareholding may cause the company to lose all its imputation credits. New Zealand also has a broad definition of 'dividend' which can also include some returns of original share capital. The risk of withholding tax in such

circumstances can affect a foreign investor's willingness to invest in New Zealand, so reduced DTA withholding rates may therefore increase investment into New Zealand.

3.13.3 *Certainty*. A reduced rate in a DTA also gives investors greater certainty as the rates cannot be raised without renegotiating the DTA.

3.14 Reducing the dividend withholding rate in a DTA to zero can have disadvantages. It means that withholding tax is not imposed where the lack of any underlying tax results from an unintended loophole in New Zealand's domestic law. The increase in anti-avoidance rules following the Base Erosion and Profit Shifting (*BEPS*) project described below provides some additional protection to address this concern.

Inserting new BEPS model treaty provisions

3.15 The Protocol also includes model treaty provisions, which arose from the OECD's BEPS project after the Existing DTA was concluded. The model provisions include anti-abuse rules to protect states against abusive practices such as treaty shopping and certain artificial arrangements. Since anti-abuse rules can reduce the certainty of tax treatment that DTAs are intended to give taxpayers, there are also model provisions to bolster DTA dispute resolution mechanisms.

3.16 Some of the new model provisions are 'minimum standards' which are mandatory for all jurisdictions committed to BEPS (which both New Zealand and Austria are). The OECD is leading an international peer review process that monitors countries' compliance with those minimum standards. Other model provisions are recommended as 'best practice' but are not mandatory.

3.17 New Zealand's DTAs are being updated to include BEPS model provisions through an overriding multilateral treaty, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI). However, the MLI will not update the Existing DTA as Austria did not nominate for it to be covered by the MLI, because of the MFN obligation. For this reason, the bilateral negotiations with Austria provided an opportunity to agree the specific BEPS model provisions to be included in the Existing DTA. Including the BEPS provisions through bilateral negotiations can be preferred as

it allows countries to carefully consider which of the non-mandatory rules would be most appropriate to the particular bilateral setting.

4. Advantages and disadvantages to New Zealand of the Protocol entering into force and not entering into force for New Zealand

Advantages of the treaty entering into force

4.1 The main advantage to New Zealand of the Protocol entering into force is that it would demonstrate that New Zealand is a country that honours its international obligations. There are other advantages of the Protocol entering into force, such as the advantages associated with reduced dividend withholding rates and updating the Existing DTA for BEPS and other changes.

4.2 The advantages to New Zealand can be summarised as follows:

4.2.1 *Honouring international obligations*. The Protocol with Austria will enable New Zealand to honour its MFN obligation in the Existing DTA, enhancing New Zealand's credibility in future DTA negotiations as a country that honours its international commitments. Honouring its MFN commitments will also support positive bilateral relations with Austria and will reflect well on New Zealand's general international reputation. The Protocol will also narrow the scope of the MFN obligation going forward so that it only applies in respect of New Zealand's DTAs with other European Union countries, rather than with other OECD countries.

4.2.2 *Reciprocity for New Zealanders investing in Austria*. The key change in the Protocol is a reciprocal reduction in dividend withholding tax rates. Since New Zealand's domestic withholding rate on most fully imputed dividends is already 0%, the DTA reduction benefits New Zealanders investing in Austria by allowing them to enjoy lower dividend withholding rates in Austria. The reciprocal reduction also benefits New Zealand by reducing the need to give foreign tax credits to such investors for Austrian tax paid. However, Austria is not a major economic partner for New Zealand and so these may not be significant benefits in practice.

4.2.3 *BEPS provisions*. The inclusion of the new BEPS model anti-abuse provisions will strengthen New Zealand's ability to counter treaty abuse and protect its tax base. In addition, it will position New Zealand well for facing international peer review of the BEPS minimum standards, as the Existing DTA will be fully compliant with the internationally imposed standards.

4.2.4 *Other minor changes*. The remaining changes made to the Existing DTA will collectively provide various marginal benefits. Of these, the inclusion of an Assistance in Collection provision is likely to prove the most advantageous, as it will improve Inland Revenue's ability to recover unpaid tax debt from taxpayers who have migrated to Austria.

Disadvantages of the treaty entering into force

4.3 The main disadvantage for New Zealand of the Protocol entering into force will be any fiscal cost arising from the reduced dividend withholding tax rates (see section 8 below). As noted above at paragraph [3.12], the domestic rate of NRWT is already 0% for fully imputed dividends from direct investment, so the Protocol would only reduce rates for unimputed dividends. The fiscal cost of the Protocol is therefore not expected to be significant.

4.4 There may also be a perceived disadvantage of the Protocol entering into force, as the only substantial investment between Austria and New Zealand is an Austrian investment into the oil and gas sector in New Zealand. The Austrian investor in that New Zealand petroleum miner will benefit from the reduced withholding rate in the Protocol for the foreseeable future, but only to the extent those dividends are not fully imputed (because New Zealand company tax has not been paid on the profits).

4.5 Given the Government's current commitment to reduce New Zealand's greenhouse gas emissions, this change to the Existing Treaty could be perceived as a disadvantage. However, the Protocol (and tax treaties generally) does not give entities in any sector benefits not available generally. The benefits in the Protocol are also available to Austrian investments in other sectors. For this reason, this change does not give any preferential treatment to the oil and gas sector.

4.6 Inland Revenue may incur some additional administrative costs as a result of certain provisions in the Protocol. As explained below at paragraphs [8.6.2], these are expected to be minor.

Advantages of the treaty not entering into force

4.7 It is an option not to bring the Protocol with Austria into force. In that case, the disadvantages identified above will not arise.

Disadvantages of the treaty not entering into force

4.8 If the Protocol is not brought into force, New Zealand will fail to honour the MFN commitment it made to Austria in the Existing DTA. This would likely have negative repercussions for New Zealand's international relations, both in terms of our bilateral relationship with Austria and our international reputation more generally. It may impact on New Zealand's credibility in future treaty negotiations.

4.9 Without the Protocol, it is unlikely that the BEPS provisions could be incorporated into the Existing DTA in the short term.

4.10 Furthermore, the other advantages discussed above would not be secured.

5. Legal obligations which would be imposed on New Zealand by the treaty action, the position in respect of reservations to the treaty, and an outline of any dispute settlement mechanisms

Overview of key legal obligations

5.1 DTAs do not impose requirements on taxpayers. The obligations DTAs impose only apply to the respective Governments. The principal changes to the obligations that will be imposed on New Zealand by the Protocol can be grouped as follows:

5.1.1 *Reduced withholding tax rates on dividends*. This is the main purpose of the Protocol and was triggered by the MFN obligation in the Existing DTA.

5.1.2 *Inclusion of BEPS minimum standard provisions*. Minimum standards are mandatory for all jurisdictions committed to BEPS, including New Zealand.

New Zealand is subject to an OECD peer review process under which our compliance with those minimum standards is monitored.

5.1.3 *Inclusion of some BEPS 'best practice' provisions*. The OECD's 'best practice' provisions are not subject to peer review. A country may, however, request feedback from peers on how it has adopted best practices.

5.1.4 *Other changes*. The Protocol contains several other changes to update the Existing DTA as agreed.

Reduced dividend withholding rates

5.2 Article VIII reduces withholding tax rates on dividends. The dividend withholding tax rate in the Existing DTA is 15%.

5.3 Under the Protocol, the dividend withholding rate would be:

5.3.1 0%, if the beneficial owner of the dividend is a company that owns, directly or indirectly, at least 80% of the company paying the dividend for at least 12 months before the dividend is declared, or

5.3.2 5%, if the company receiving the dividend directly owns at least 10% of the company paying the dividend for a period of at least 365 days that includes the date the dividend is paid, or

5.3.3 15% in all other cases.

5.4 To qualify for the 0% dividend withholding rate, certain additional requirements must be met. These are generally intended to ensure that the company paying the dividend is owned directly or indirectly by a listed company, or through a chain of companies where each company in the chain is entitled to a 0% rate under a DTA. If the requirements cannot be met, New Zealand and Austria's competent authorities[1] may agree to allow a 0% rate as long as the arrangement is not considered abusive.

BEPS minimum standards

[1] New Zealand's competent authority is the Commissioner of Inland Revenue or an authorised representative. Austria's competent authority is the Federal Minister of Finance or an authorised representative.

5.5 The Protocol would incorporate the following BEPS minimum standards:

5.5.1 *Preamble*. The preamble of the Existing DTA will be updated to include an explicit reference to ‘the prevention of tax evasion and avoidance’, to ensure that courts are able to take this purpose into account in interpreting the DTA. The Protocol will also update the title of the Existing DTA to reflect this change, although this is not actually required as a BEPS change.

5.5.2 *Entitlement to Benefits*. Article XV of the Protocol will insert a new Article in the Existing DTA, which will include in particular, a ‘principal purpose test’. The test can deny a treaty benefit if one of the principal purposes of an arrangement is to obtain that benefit, unless the granting of that benefit in the circumstances is in accordance with the object and purpose of the DTA.

5.5.3 *Notification of MAP cases*. Article XVI of the Protocol would amend paragraph 11 of the current protocol to the Existing DTA. The change would require the competent authorities of each State to notify the other if a taxpayer submits a case to it under Article 24(1) (Mutual Agreement Procedure) but the competent authority decides the case is not justified.

BEPS ‘best practice’ provisions

5.6 The Protocol includes a range of best practice measures to protect against specific treaty abuse problems, including:

5.6.1 *Confirming residence taxing rights*. The Protocol would insert an explicit provision in Article 1 (Persons Covered) of the Existing DTA to clarify that, except in specified circumstances, a DTA cannot be construed as restricting the right of a State to tax its own residents.

5.6.2 *Dual resident tiebreaker*. The Existing DTA contains tiebreaker tests for establishing residence where a taxpayer is dual resident (that is, resident in both States under each State’s domestic laws). The update provides that, if it is unclear how the tiebreaker should be resolved in the case of a non-individual, treaty benefits will be denied unless the competent authorities of the States agree otherwise.

5.6.3 *Alienation of Property*. Under the Existing DTA, the State in which land and other immovable property is situated (the source State) has the primary taxing right to gains from the sale of that property. Gains from the sale of shares, however, are only taxable in the State in which the seller is resident (the residence State). To prevent taxpayers from defeating a source State's taxing rights by selling shares in a land-rich company instead of the land itself, the Existing DTA contains an anti-avoidance 'land rich company' rule in Article 13 (Alienation of Property). The update extends this principle to interests comparable to shares such as interests in a partnership or trust. It also inserts a holding period to ensure the provision would capture the sale of interests in an entity that was land-rich at any time during the 365 days preceding the sale.

5.6.4 *Permanent establishment provisions*. A permanent establishment (*PE*) is a substantial physical presence in a State. A PE is an important concept in DTAs, as source States will often be denied taxing rights unless there is a PE in that State. Taxpayers may therefore try to avoid source taxation by avoiding a PE in the source State. The Protocol contains several best practice provisions aimed at the artificial avoidance of PE status. These include:

i. A range of changes intended to bolster the rules contained in Article 5 (Permanent Establishment), such as clearer rules for the exclusion in the Article for preparatory and auxiliary activities and for determining when the activities of a dependent agent and commissionaire arrangements will constitute a permanent establishment.

ii. A specific rule to prevent treaty abuse through the use of PEs in a third state. This is to be included in the new Entitlement to Benefits Article (Article 26A). The new rule denies treaty benefits where the residence jurisdiction exempts profits attributable to a PE in a third jurisdiction but the profits are not taxed or receive preferential tax treatment in that third state.

5.6.5 *Arbitration*. The Protocol would include a provision in Article 24 (Mutual Agreement Procedure) of the Existing DTA to allow a taxpayer to take their case to independent arbitration. The taxpayer may do this when the competent

authorities of the two States disagree on how the case should be treated and cannot resolve that dispute by mutual agreement within three years. However, a case may not be submitted to arbitration if it involves the domestic anti-avoidance rules of either Austria or New Zealand. This update is intended to address the potential loss of certainty that taxpayers may face from the introduction of the BEPS treaty anti-abuse rules outlined above.

Other changes

5.7 The Protocol makes other changes to the Existing DTA. These are:

5.7.1 *A rule for undefined terms*. Under the Existing DTA, terms not defined in the DTA have their domestic law meaning unless the context requires otherwise. Consistent with recent updates to the OECD Model, the Protocol introduces a new rule for undefined terms that allows the competent authorities of New Zealand and Austria to agree a different meaning under the mutual agreement procedure in Article 24. This change supports the ability of the tax authorities to resolve interpretative difficulties via mutual agreement.

5.7.2 *Time limit on transfer pricing adjustments*. The Protocol would insert a new rule in Article 9 (Associated Enterprises), which imposes a 10-year time limit on each side's taxation authority for making transfer pricing adjustments. The limit would not apply in cases of fraud, gross negligence or wilful default. This change will have no practical effect in New Zealand as a more limited (7-year) time bar already applies under domestic law.

5.7.3 *Sovereign immunity for interest*. The Existing DTA includes a sovereign immunity provision that exempts from withholding tax interest paid to the Governments of New Zealand or Austria or a national credit office of either of the countries. The Protocol would update this exemption to apply to the central banks of New Zealand and Austria and to the subsidiary of Austria's export credit agency (which itself is already listed in the DTA as Oesterreichische Kontrollbank Aktiengesellschaft). It also explicitly names New Zealand's Export Credit Office whereas previously it just referred to an entity of a "similar nature" to Austria's export credit agency.

5.7.4 *Definition of royalties*. The Protocol would remove from the definition of 'royalties' in the Article 12 (Royalties) a reference to "payments for the use of industrial, commercial and scientific equipment". This reference is from the United Nations Model Tax Convention rather than the OECD Model. New Zealand routinely seeks to include this in its DTAs but has, more recently, often been unsuccessful in securing it. Removing the reference was part of agreement to other elements of the package.

5.7.5 *Exchange of information*. The Protocol would make the following three changes relating to Article 25 (Exchange of Information):

- Include a new standard international rule that allows exchanged information to be used for purposes other than those specified in the DTA provided (1) such use is consistent with the domestic laws of both States, and (2) the competent authority of the side providing the information authorises such use.

- Include a long-standing international rule that ensures DTA exchange of information provisions override any domestic bank secrecy rules of either side.

- Specify the information that a tax authority must provide when requesting information from the other tax authority and clarify the extent to which information may be requested.

5.7.6 *Assistance in Collection of Taxes*. This was a new Article introduced into the OECD Model in 2003. Under this Article, the two sides can request administrative assistance from each other in the collection of unpaid taxes owed by absconding taxpayers.

5.7.7 *MFN obligation*. As noted above, the Protocol would amend the wording of the MFN obligation in the Existing DTA so that it will only be triggered by future New Zealand DTAs with EU member countries instead of OECD countries.

6. Measures which the Government could or should adopt to implement the treaty action, including specific reference to implementing legislation

6.1 Following the completion of the Parliamentary Treaty Examination process, the Protocol will be incorporated into New Zealand legislation by an Order in Council made pursuant to section BH 1 of the Income Tax Act 2007. Section BH 1 gives overriding effect to all DTAs by Order in Council. The override relates only to tax matters, and only the Inland Revenue Acts,[2] the Official Information Act 1982 and the Privacy Act 1993 are overridden.

6.2 The override of the Inland Revenue Acts is necessary to give effect to the provisions of the Protocol, which may provide relief from tax obligations that would otherwise be imposed under those Acts. The override of the Official Information Act 1982 is necessary to ensure that confidential communications with Austria during and after the negotiations do not have to be disclosed. The override of the Privacy Act 1993 is necessary to ensure that information regarding natural persons can be exchanged according to the terms of the Protocol.

6.3 As an alternative to the Order in Council mechanism, the Protocol could be given the force of law by enactment of a dedicated statute. However, this option would unnecessarily increase the amount of primary tax legislation and is not preferred.

6.4 Article XVII of the Protocol provides for the agreement to be brought into force through an exchange of diplomatic notes between New Zealand and Austria. New Zealand will be able to notify Austria that all procedures required by domestic law have been completed once the Order in Council referred to in paragraph [6.1] has been made and is in force. Once Austria's diplomatic note is received by New Zealand, the Protocol will enter into force on the date of the later of the two notes.

6.5 Article XVII also provides for the dates of effect that will apply once the Protocol is in force.

6.5.1 In relation to withholding taxes, the Protocol provisions will have effect on the first day of the second month next following the date of entry into force.

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[2] This includes the Income Tax Act 2007, Tax Administration Act 1994 (TAA) and other Acts specified in Schedule 1 of the TAA.

6.5.2 The remaining Protocol provisions will generally have effect in New Zealand for income years beginning on or after 1 April next following the date of entry into force, and for Austria for income years beginning on or after 1 January next following the date of entry into force.

7. Economic, social, cultural, and environmental costs and effects of the treaty action

7.1 The overall impacts of the Protocol are expected to be favourable.

7.2 The economic impacts are mixed. The reduced withholding tax rates on dividends are consistent with New Zealand's DTA policy, which has positive economic impacts such as incentivising direct investment between Austria and New Zealand and reducing the need for New Zealand to provide foreign tax credits to New Zealanders investing in Austria. However, reduced dividend withholding tax rates may have a fiscal cost to New Zealand. Although this cost is not expected to be significant, on balance, we expect the fiscal impacts of the Protocol may be slightly negative over the longer-term. This is largely because there is existing material investment from Austria into New Zealand but not in the other direction (see further section 8 below), and it is not expected that the Protocol will (by itself) significantly increase investment or trade between Austria and New Zealand in the short term.

7.3 Social impacts are expected to be positive. The Protocol will reinforce the existing relationship between New Zealand and Austria by honouring the MFN obligation. It will also reduce the scope for tax avoidance, which can erode social cohesion and trust, through the anti-abuse provisions.

7.4 The environmental impacts of the Protocol are expected to be neutral. As mentioned at paragraph [4.4], the only material investment between Austria and New Zealand currently is an existing Austrian investment in New Zealand's oil and gas industry. However, the Protocol is not targeted at any industry and does not incentivise oil and gas over clean energy or other businesses. The Protocol does make it easier for capital gains earned in New Zealand to be more easily returned to the Austrian parent. But this is just as likely to reduce oil and gas investment in New Zealand (since those gains can then be invested elsewhere) as it is to increase it.

7.5 It is not expected the Protocol will have any cultural impacts.

8. The costs to New Zealand of compliance with the treaty

Costs of reduced dividend withholding rates

8.1 For outbound dividends paid by a New Zealand company to an Austrian shareholder, the Protocol reduces the dividend withholding tax that New Zealand can impose from 15% to either 0% or 5% in specified circumstances.

8.2 The overall fiscal costs of the withholding tax reductions were considered when making the original policy decisions to provide a zero rate in our treaties with major trading partners. Ordinarily, the cost of any rate reduction would be offset by a reciprocal reduction in Austrian tax from dividends paid by an Austrian company to New Zealand investors (for which New Zealand would otherwise have to give a foreign tax credit). In a DTA between countries with reciprocal levels of trade and investment, the offsets will be equal over time.

8.3 Currently, however, there is no material investment in Austria from New Zealand but we are aware of one material direct investment from Austria in New Zealand (in the oil and gas sector described above at paragraphs [4.4] and [7.4]). Despite this imbalance, there is not expected to be a significant fiscal cost to New Zealand from reducing the dividend withholding rate, as the reduction will only affect unimputed dividends. (As explained in paragraph [3.12], New Zealand already applies a 0% NRWT rate under its domestic law to fully imputed dividends paid to direct investors.)

8.4 Unimputed dividends often arise from untaxed capital gains. However, the likelihood of untaxed capital gains in the case of the Austrian investment is low, as the investment is primarily in the oil and gas sector. In that sector, assets are typically held on revenue account rather than capital account, which means that gains on sale are usually taxed in New Zealand. Another circumstance in which unimputed dividends can arise is where more than 34% of the company’s shareholding changes, in which case it loses all of its imputation credits. However, there is no evidence that this is likely to happen in this case.

8.5 A fiscal cost is therefore only expected to arise if the New Zealand petroleum miner derives untaxed capital gains that it repatriates to its Austrian parent. It is not possible to estimate this cost because it will depend on future events and business decisions. Untaxed capital gains may not arise at all, and it is not possible to predict the size of such gains if they do. But as untaxed capital gains are uncommon in the oil and gas sector, the fiscal cost is not expected to be significant.

Costs of other changes

8.6 Certain other changes made by the Protocol to the Existing DTA could also give rise to minor costs to the New Zealand Government:

8.6.1 The Protocol would extend sovereign immunity from interest withholding tax to Austria's central bank and the subsidiary of its export credit agency. However, this new arrangement is reciprocal with sovereign immunity being extended to the Reserve Bank of New Zealand and the New Zealand Export Credit Office.

8.6.2 Inland Revenue may incur some additional administrative costs, as a result of certain provisions in the Protocol that require the competent authorities of both countries to mutually discuss issues or to provide assistance in collection of taxes. These costs are expected to be minor and no increase of baseline funding will be sought. Inland Revenue's experience is that the main effect of such provisions is deterrence, as such provisions are rarely exercised in practice. For example, the arbitration facility incentivises the two sides to resolve issues before arbitration is invoked. The costs may also be offset by the improved revenue collection expected from the assistance in collection from Austria for New Zealand taxes and anti-abuse provisions.

8.6 Compliance costs borne by New Zealand taxpayers are not expected to change. There may be a small increase in compliance costs borne by investors to the extent that they are currently engaging in BEPS activities if they restructure to avoid the application of the anti-abuse provisions in the Protocol.

9. Completed or proposed consultation with the community and parties interested in the treaty action

9.1 The Treasury and the Ministry of Foreign Affairs and Trade were consulted about the content of this extended NIA. There has also been consultation with Austrian stakeholders regarding their investment in the mining and petroleum sector. This is in line with the existing practice of consultation with stakeholders regarding specific issues with New Zealand's existing DTAs as they arise.

9.2 Consistent with international practice, officials do not undertake public consultation on the negotiation of bilateral tax treaties. New Zealand's negotiating model is based on the OECD Model. With the exception of a few countries, most jurisdictions do not make their negotiating models public and negotiations are therefore also confidential.

9.3 As issues are discussed and considered for inclusion in the update to the OECD Model, the OECD seeks public feedback, including from the OECD's Business and Industry Advisory Committee, which consists of business representatives from around the world. The OECD also consulted extensively on its BEPS work. Feedback was provided (including by interested parties from New Zealand) while the OECD undertook work on the updated BEPS provisions.

10. Subsequent protocols and/or amendments to the treaty and their likely effects

10.1 There is no amendment clause in either the Protocol itself or the Existing DTA. Further amendments will be considered on a case-by-case basis as circumstances dictate, in accordance with the usual requirements of the Vienna Convention on the Law of Treaties and subject to New Zealand's normal domestic approval procedures. No future amendments are currently anticipated.

10.2 No formal review is planned for the Protocol or the Existing DTA. However, the two sides, through their competent authorities, are authorised to remain in contact to resolve any interpretation and application issues. In addition, taxpayers and practitioners are able to raise issues with the competent authorities. In the case of New Zealand, competent authority contact details can be found on the Inland Revenue website.

11. Withdrawal or denunciation provision in the treaty

11.1 The Protocol amends the Existing DTA and as such does not include a withdrawal or denunciation provision.

11.2 Article 28 of the Existing DTA sets out provisions for terminating the DTA itself. Either side may terminate by giving written notice through diplomatic channels on or before 30 June of any calendar year at least 5 years after its entry into force. Upon such notification, the DTA (including the provisions of the Protocol incorporated into it) would cease to apply:

11.2.1 for withholding taxes, on the first day of the third month following notice of termination;

11.2.2 for other New Zealand tax, for income years beginning on or after 1 April of the next calendar year following the notice of termination, and;

11.2.3 for other Austrian tax, for assessment years beginning on or after 1 January of the next calendar year following the notice of termination.

11.3 Article 28 generally follows the approach used in New Zealand's other DTAs.

12. Agency Disclosure Statement

12.1 Inland Revenue is solely responsible for the analysis and advice set out in this extended National Interest Analysis, except as otherwise explicitly indicated. This analysis and advice have been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

12.2 Inland Revenue has analysed the issue of implementing the Protocol between Austria and New Zealand, and the legislative and regulatory proposals arising from that implementation. As part of that process, Inland Revenue considered the option of not entering into the Protocol and therefore retaining the existing DTA unchanged as the status quo. A full renegotiation of the existing DTA was not considered necessary as the Existing DTA was still relatively recent.

12.3 If the Protocol enters into force, officials expect compliance costs will broadly stay the same, administration costs will increase (but only at the margins), and any impact on bilateral trade and investment is expected to be small. Due to data limitations officials are unable to quantify the impacts, although they are likely to be minor or small.

12.4 The Treasury and the Ministry of Foreign Affairs and Trade have been consulted about the content of this extended NIA. However, consistent with standard international practice, no wider consultation was undertaken.

12.5 Inland Revenue's view is that the policy options considered will not impose additional costs on business interests; nor impair private property rights, market competition, or the incentives for business to innovate and invest; nor override fundamental common law principles.

12.6 There are no areas of incompatibility with the Government's "Expectations for the design of regulatory systems".

Prepared by: Inland Revenue Department
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