International treaty examination of the Convention between New Zealand and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Report of the Finance and Expenditure Committee

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Recommendation

The Finance and Expenditure Committee recommends that the House take note of its report.

The Finance and Expenditure Committee has examined the Convention between New Zealand and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income. The national interest analysis for the convention is appended to this report.

The convention will replace an existing agreement with Canada that dates back to 1980. It updates the existing convention to reflect international developments and changes in each country's treaty policy since then, to ensure that arrangements governing double taxation between New Zealand and Canada are up-to-date and provide the degree of certainty and protection that taxpayers expect. The main change to the agreement is the reduction of withholding tax rates on dividends, interest, and royalties in line with New Zealand's wider strategy on treaty withholding tax rates. The revenue cost to New Zealand as a result of the reduction in withholding rates is expected to be relatively small, at approximately half a million dollars per year.

Labour members understand and accept that overseas investors into New Zealand do not receive the full range of government services paid for out of taxes, such as healthcare, and should not pay the full rates of tax paid by New Zealanders who do. Nevertheless, overseas investors do benefit from the societal settings maintained through taxation including a healthy, well-educated population, and enforcement of property rights and the rule of law. Because overseas investors do benefit from taxes, they should pay some tax, albeit at lower rates.

Appendix A

Committee procedure

The international treaty examination of the Convention between New Zealand and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income was referred to us by the Foreign Affairs, Defence and Trade Committee on 28 June 2012. We met on 25 July, and 1 and 2 August 2012 to consider the convention, and received advice from the Inland Revenue Department.

Committee members

Todd McClay (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
Hon Clayton Cosgrove
Paul Goldsmith
John Hayes
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Hon Dr Nick Smith

Appendix B

Agreement between Canada and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

National Interest Analysis

Executive summary

The *Agreement between Canada and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* and its accompanying Protocol (collectively known as "the new DTA") has been negotiated to replace an existing agreement with Canada (the existing DTA) that dates back to 1980. Canada is a significant trading partner for New Zealand and an important source of investment. As of March 2011, Canada was our 10th largest investment partner and the total stock of investment between the two countries was worth $3.15 billion. Canada is also our 19th largest bilateral trade partner. In the year to June 2011, total bilateral trade between New Zealand and Canada was worth $1.07 billion.

The new DTA updates the existing DTA to reflect international developments and changes in each country's treaty policy since 1980. The new DTA represents an improvement on the existing DTA and because of this should be welcomed by taxpayers.

The DTA is expected to enhance New Zealand's cross-border trade and investment by

- providing greater certainty in respect of the taxation of cross-border income
- reducing compliance costs
- lowering withholding taxes on dividends, interest and royalties (with rates in line with New Zealand's broader tax treaty strategy).

The new DTA is intended to ensure the arrangements governing double taxation between New Zealand and Canada are up-to-date and provide the levels of certainty and protection that taxpayers expect from a modern treaty.

The allocation of taxing rights under the new DTA for the most part remains unchanged from the existing DTA. The most significant change to the agreement is the reduction of withholding tax rates on dividend, interest, and royalties which, as explained above, have been reduced in line with New Zealand's new, wider strategy on treaty withholding tax rates. The revenue cost to New Zealand as a result of the reduction in withholding rates is expected to be relatively small, at approximately $0.5 million per year.

On balance, officials are satisfied that the potential advantages to New Zealand from the new DTA with Canada entering into force will outweigh any potential disadvantages.

It is proposed that the new DTA will be incorporated into domestic legislation through an Order in Council. The new DTA will then be brought into force through an exchange of diplomatic notes. The new DTA will enter into force on the date of the later of the two notes.

Nature and timing of the proposed treaty action

The Agreement between Canada and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and its accompanying Protocol (collectively known as "the new DTA") was signed in Wellington on 3 May 2012. It was signed in English and French, with both texts having equal authority. The English text of the new DTA is attached at Annex 1.

Subsequent to satisfactory completion of the Parliamentary treaty examination process, in accordance with Standing Orders 394 to 397, the new DTA will be incorporated into domestic legislation through an Order in Council.

In accordance with Article 28 of the new DTA, the new DTA will then be brought into force through an exchange of diplomatic notes confirming the completion of all necessary domestic procedures for entry into force in each country. The new DTA will enter into force on the date of the later of these notes. It is expected that the new DTA will enter into force by the end of 2012.

As each provision of the new DTA comes into effect in accordance with Article 28, the equivalent provision of the existing DTA will cease to have effect. The existing DTA will terminate once all of its provisions cease to have effect.

Like other DTAs, the new DTA will not apply to the Cook Islands, Niue, or Tokelau.

Reasons for New Zealand becoming party to the treaty

Canada is one of New Zealand's key trading and investment partners. As of March 2011, Canada was our 10th largest investment partner, and the total stock of investment between the two countries was worth $3.15 billion. Canada is also our 19th largest bilateral trade partner. In the year to June 2011, total bilateral trade between New Zealand and Canada was worth $1.07 billion. Exports to Canada in this period were worth $540 million. (New Zealand export figures to Canada may be higher as exports to Canada via the United States are not reflected in official statistics.) In the same period, New Zealand's imports from Canada were worth NZ$529.7 million. (Further information about investment and trade flows between New Zealand and Canada is attached as Annex 2.)

Given Canada's position as one of New Zealand's key trading partners, it is important for the treaty to be kept up-to-date and reflect each country's current treaty policies.

The existing DTA was concluded in 1980 and is one of New Zealand's older tax treaties. As such, the existing treaty does not reflect international developments or developments in New Zealand's treaty policies and practices. In particular, the withholding tax rates specified in the existing DTA are substantially higher than those in our more recent DTAs.

The new DTA represents an improvement from the existing treaty and will provide the levels of certainty and protection that taxpayers expect from a modern treaty. Amongst

other things, the new DTA includes lower withholding tax rates, similar to those agreed to in the recent Protocol with the United States and the new Australia-New Zealand double tax agreement (DTA). The new DTA reflects New Zealand's more recent treaty policies.

What double tax agreements do

Double tax agreements (DTAs) foster growth in economic activity between countries by reducing tax impediments to cross-border services, trade, and investment. Essentially, DTAs provide bilateral solutions to problems that are difficult to solve unilaterally. They provide greater certainty of tax treatment, provide a basis for sharing the cost of relieving double taxation, provide a bilateral basis for limiting withholding taxes on cross-border investment returns, reduce compliance costs for business, and exempt certain short-term activities from tax in the jurisdiction in which the activities are conducted.

New Zealand concluded its first DTA in 1947 with the United Kingdom. Since then, New Zealand has progressively developed a network of DTAs, predominantly with its main trading and investment partners, and has 37 DTAs now in force.

New Zealand enters into DTAs in large part on the basis of self-interest. That is, because DTAs create favourable conditions for increased economic activity between countries, they are expected to be beneficial to New Zealand in economic and fiscal terms at a national level.

More generally, however, DTA networks also make an important contribution to the expansion of world trade and to the development of the world economy. These are also key objectives of the OECD. The OECD has assumed a leading role, internationally, in promoting the use of DTAs.

In particular, the OECD has produced a Model Tax Convention, together with a comprehensive commentary, for member and non-member countries to use as a basis for concluding DTAs. The OECD Council has also issued an express recommendation to all member countries:

- "to pursue their efforts to conclude bilateral tax conventions … with those member countries, and where appropriate with non-member countries, with which they have not yet entered into such conventions…
- when concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention, as interpreted by the Commentaries thereon."[1]

DTAs provide the following general benefits:

[1] The recommendation was issued by the OECD Council on 23 October 1997, but follows similar recommendations that have been in place since before New Zealand joined the OECD.

- *Benefits to taxpayers*. A key concern for any taxpayer wanting to enter into commercial activity in another jurisdiction is the requirement to comply with the tax and other legal obligations of two separate jurisdictions. This can be perplexing, and obtaining professional advice or tax rulings can be costly and time-consuming. Unique issues also arise from cross-border activities. These issues range from the complex, such as transfer pricing disputes, to the more mundane, such as whether taxes paid in the other jurisdiction are creditable against home jurisdiction tax. DTAs help alleviate many of these problems. For example, they establish a framework for the taxation of cross-border activity, prohibit the application of discriminatory taxes, and establish a mutual agreement procedure for resolving tax disputes. The mutual agreement procedure is a key benefit for taxpayers. It is not a full disputes resolution mechanism as it only obliges the two tax authorities to endeavour to resolve issues. However, it enables tax authorities to have a dialogue about a taxpayer's issues. It also provides a low compliance-cost alternative to seeking redress through the Courts for taxpayers concerned that they have not been taxed correctly in either or both jurisdictions (including in transfer pricing cases).
- *Benefits to investors.* Investing across an international border often involves risk. Among other things, tax laws tend to be very complex and can change suddenly. DTAs assist investors by specifying the maximum rates of withholding taxes that can be applied to dividends, interest, and royalties. These "headline" rates reduce compliance costs for investors by making it easier to determine the after-tax returns on potential investments. The fact that the rates are "locked in" by treaty means that investors can make business decisions with more confidence.
- *Benefits to governments.* Low tax rates can lead to increased foreign investment and a reduction in the cost of importing capital. Countries may lower their tax rates unilaterally. However, a benefit of lowering tax rates in a bilateral treaty setting is that it ensures that the rates are also lowered on a reciprocal basis by the treaty partner. This secures benefits for domestic investors. In addition, the reduced foreign tax can flow through to the New Zealand tax base through a reduced need to provide foreign tax credits.
- *Relief of double taxation.* Double taxation distorts business decisions and generally hinders cross-border economic activity. In recognition of this, most jurisdictions unilaterally relieve double taxation of their tax residents. This is typically achieved by means of a tax credit mechanism, but some jurisdictions prefer an exemption method. However, in the absence of a DTA, a jurisdiction bears the full cost of relieving double taxation itself. DTAs allow the cost of relieving double taxation to be shared. They do this by allocating taxing rights between the jurisdictions concerned, on the basis of internationally accepted principles as set out in the OECD Model Tax Convention.

- *Bilateral co-operation for administration of tax laws*. It is an internationally accepted principle that countries do not assist each other in the enforcement of tax laws.[2] However, most countries tax their residents on income earned worldwide. International co-operation between tax authorities is also needed to enable tax authorities to verify that offshore income is being correctly reported by their tax residents. DTAs resolve this problem by establishing bilateral treaty arrangements for the exchange of tax-related information such as tax records, business books and accounts, bank information and ownership information. The information that is exchanged assists tax authorities to detect and prevent tax evasion and tax avoidance. More generally, the mere existence of DTAs can deter evasion and avoidance. This is one of the key benefits of DTAs for governments. The recent global financial crisis has highlighted the importance of bilateral co-operation in the form of exchange of information, and there is now a very strong international imperative (driven by the G-20 and the OECD) for all governments to enter into comprehensive exchange of tax information networks with relevant partners.

Advantages and disadvantages to New Zealand of the treaty entering into force and not entering into force for New Zealand

As a bilateral instrument, the new DTA involves a trade-off between advantages and disadvantages to New Zealand. On balance the new DTA is expected to be beneficial to New Zealand.

Advantages to New Zealand of the new DTA entering into force

DTAs are generally designed to foster increased trade and investment. Canada is a key trading and investment partner. It is important to New Zealand's interests that a DTA between Canada and New Zealand remains up-to-date and relevant to the prevailing business environment. The new DTA will update existing arrangements to ensure the DTA provides modern levels of certainty and protection with respect to cross-border income earning activities between the two countries.

The allocation of taxing rights under the new DTA largely remains unchanged from existing arrangements. However, withholding tax rates imposed by both New Zealand and Canada on dividend, interest, and royalties have been reduced in line with New Zealand's new, wider strategy on treaty withholding tax rates.

- *Dividends:* the dividend withholding tax rate will be reduced from 15 percent to 5 percent of the gross amount of the dividends if the dividend is paid to a company that directly owns at least 10 percent of the voting power of the company paying the dividend.
- *Interest:* the interest withholding tax rate will be reduced from 15 percent to 10 percent generally and a rate of 0 percent for financial institutions provided the approved issuer levy is paid by the New Zealand borrower.

[2] In New Zealand, this principle is stated in Connor v Connor [1974] 1 NZLR 632.

- *Royalties:* in the case of royalties, the withholding tax rate has been reduced from 15 percent to 10 percent generally. However, a further reduced rate of 5 percent applies for copyright royalties and royalties for computer software and other patent or information concerning industrial, commercial, or scientific experience.

The new DTA has anti-abuse provisions that are aimed at preventing persons who are not entitled to the low treaty withholding tax rates from gaining access to those low rates.

Disadvantages to New Zealand of the new DTA entering into force

New Zealand may forgo some revenue because of the reduction on withholding taxes from the existing DTA. However, the reciprocal nature of the DTA means that these revenue costs will be offset by increases in revenue when taxing rights are allocated to New Zealand and Canadian tax is correspondingly reduced or eliminated under the new DTA. The revenue cost to New Zealand arising from the reduction in withholding taxes is estimated to be $0.5 million per year.

The new DTA provides for the assistance in collection of taxes imposed by the other country. Inland Revenue will incur some costs if a request for assistance in collection is made by the Canadian Revenue. However, New Zealand has entered into such arrangements in a number of its treaties and has a well-established system to deal with any requests. It is expected that any cost incurred will be marginal. Furthermore, the arrangement is reciprocal which means New Zealand will be able to make a request to the Canadian Revenue for assistance to collect taxes on behalf of New Zealand in Canada.

There are some general disadvantages to concluding a DTA (for example the "locked- in" nature of a treaty or the costs incurred in administering the exchange of information provisions), these disadvantages are not as relevant for a renegotiation of an existing DTA as many of these disadvantages have already been absorbed by New Zealand. Therefore, apart from the reduction in revenue and marginal increase in administration costs as discussed previously, there are no new disadvantages created as a result of the new DTA.

It would be an option for New Zealand not to enter into the new DTA with Canada. This would mean the existing DTA will continue to apply but would not reflect developments in New Zealand's treaty policies and practices. In particular, the high withholding tax rates on dividends, interest, and royalties would continue to apply.

Conclusion

On balance, it is considered to be in New Zealand's interests to conclude the new DTA with Canada. It is expected that a more modernised DTA will enhance cross-border trade and investment by providing greater certainty in the taxation of cross-border trade. It will also bring the DTA with Canada in line with New Zealand's current strategy on withholding taxes.

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

The new DTA will not impose any requirements on taxpayers. The obligations it will impose are on the respective Governments, restricting their taxing rights under domestic

law on a reciprocal basis and requiring the provision of assistance in the exchange of information in relation to tax matters and the collection of taxes. The new DTA will not require the imposition of any tax that is not already imposed under domestic law.

Where income is derived from one country (the country of source) by a tax resident of the other country (the country of residence) the country of residence generally retains taxing rights under the new DTA. The main impact of the DTA is to restrict the ability of the country of source to tax the income in certain circumstances. Where both countries are permitted to tax the income, the DTA requires the country of residence to provide a credit for the tax imposed by the country of source. The broad framework for allocating taxing rights under the new DTA is essentially unchanged from the existing DTA. The key provisions of the DTA are as follows:

Business profits (Articles 5 and 7)

Similar to the existing DTA, the new DTA will ensure that business profits of an enterprise will be taxable only in the jurisdiction where the enterprise is a tax resident unless profits are derived through a permanent establishment in the jurisdiction of source. In that case, the profits may be taxed in the source jurisdiction. A permanent establishment generally exists in the jurisdiction in question when there is a fixed place of business through which the business of an enterprise is wholly or partly carried on. However, article 5 includes a number of clarifying and deeming rules that refine the permanent establishment concept. The clarifying and deeming rules are updated in the new DTA to match New Zealand's current standard treaty policy.

Income from services (Article 5)

A key change from the existing DTA is that the new DTA includes an optional OECD provision (adopted by the OECD in 2008) that deals more comprehensively with the taxation of income from services. An enterprise will be deemed to have a permanent establishment if it performs services in the other jurisdiction and either of the following criteria are met:

- the services are performed through an individual who is present in the other jurisdiction for at least 183 days in any 12-month period and more than 50 percent of the gross revenues attributable to the active business activities of the enterprise during this time are derived from the services performed in that jurisdiction through the individual; or
- the services are performed in that other jurisdiction in relation to the same or connected projects, through one or more individuals, for at least 183 days in any 12-month period. It is now standard treaty practice for New Zealand to seek the inclusion of this provision in DTA negotiations.

Income from immovable property (Article 6)

As is the case in the existing DTA, income from immovable property will generally be taxed in the jurisdiction where the property is situated.

Ship and aircraft operations (Article 8)

As is the case in the existing DTA, profits of an enterprise of a country from the operation of ships or aircraft in international traffic will generally be taxable only in that country. However, the new DTA includes a new rule that will ensure that any profits derived from domestic carriage can be taxed by the country of source. This new rule has been New Zealand standard treaty policy since 1995.

Non-resident withholding tax (Articles 10, 11 and 12)

The new DTA reduces withholding taxes, consistent with New Zealand's broader strategy on treaty withholding tax rates. The main objective of that strategy is to reduce withholding taxes on foreign non-portfolio dividends received by New Zealand residents. This will reduce tax barriers for New Zealand businesses with direct investments offshore, making it less costly to repatriate foreign profits back to New Zealand where they can be reinvested or distributed to shareholders.

The withholding tax rates in the existing DTA stand at 15 percent for dividend, interest, and royalty payments between Canada and New Zealand.

Article 10 of the new DTA limits the rate of withholding tax on dividends on a reciprocal basis to 5 percent if the dividend goes to a company owning at least 10 percent of the company making the distribution, and in all other cases the rate is 15 percent. The rates agreed in this treaty are consistent with New Zealand's overall policy of seeking to reduce rates of withholding taxes for non-portfolio dividends where possible. Note that, as was the case with the existing DTA, article 10 preserves Canada's right to impose its branch profits tax. However, the maximum rate of tax that Canada imposes has been reduced from 15 percent to 5 percent in the new DTA.

Article 11 of the new DTA generally limits the rate of withholding tax on interest on a reciprocal basis to 10 percent. For financial institutions, the withholding tax rate will be reduced to 0 percent. However, in the case of a New Zealand borrower paying interest to a Canadian financial institution, the 0 percent rate will only apply where approved issuer levy has been paid in New Zealand.

Article 12 of the new DTA generally limits the rate of withholding tax on royalties on a reciprocal basis to 10 percent per cent generally. However, a rate of 5 percent cent will apply for copyright royalties and royalties for computer software and other patent or information concerning industrial, commercial, or scientific experience. Note that the definition of royalties in the new DTA is also wider than the definition in the existing DTA – namely the definition in the new DTA includes "know-how payments" (paid for the provision of information concerning industrial, commercial, or scientific experience) and "forbearance payments" (made to secure the exclusive right to use property). These definitions are now a standard feature of New Zealand's treaty practice.

Alienation of property (Article 13)

As was the case with the existing DTA, gains from the alienation of property will generally be taxable in the country of source. However, gains from the alienation of ships or aircraft operated in international traffic will remain taxable only in the country of residence.

A new addition to the article is a feature that ensures double taxation does not occur in the case of "exit taxes" imposed on an individual who ceases to be a tax resident of one country and immediately becomes a tax resident of the other country. The individual can elect, in the new country of residence, to be treated as having alienated their assets at the time when their place of residence is changed. The mechanism is complex, but is intended to ensure that each country can only tax the amount of gain that represents an increase in value of the asset that occurred while the individual was tax resident in that country. The rule was proposed by Canada, and generally supports Canada's "exit tax" rules.

Income from employment (Article 14)

As is the case in the existing DTA, income from employment will be taxable only in the country of which the employee is a resident, unless the employment is performed in the other country and certain other criteria are met.

Directors' fees (Article 15)

As is the case in the existing DTA, directors' fees will be taxable in the country where the company paying the fees is resident.

Entertainers & sportspersons (Article 16)

The allocation of taxing rights in this article generally remains the same as the existing DTA. That is, the country of source is able to tax entertainers and sportspersons for performances within its jurisdiction, even if the person is only present there for a very short period. The new DTA also includes an anti-abuse rule to prevent individuals from circumventing the article by having their fees paid to a separate enterprise.

Pensions (Article 17)

Although the allocation of taxing rights in this article is a departure from New Zealand's preferred policy position of sole taxation by the country of residence, it remains the same as the existing DTA. Pensions and annuities will be taxable in both the country of source and the country of residence. However, the rate of tax on such payments is limited to 15 percent in the country of source. The article also provides a new provision which preserves any exemption from tax in the country of source on war pensions and allowances. Additionally, taxation of alimony payments in the country of residence will be limited to the amount that would have been taxable in the country of source if the recipient of that payment had been a resident of that country.

Government service (Article 18)

As was the case in the existing DTA, salaries and wages for services to a Government of one country will generally be exempt from tax in the other country.

Students (Article 19)

As was the case in the existing DTA, students of one country who are in the other country solely for the purpose of their education or training shall not be taxed in that other country on payments from outside that country received for the purpose of their maintenance, education or training.

Other income (Article 20)

The allocation of taxing rights under article 20 remains unchanged from the existing DTA. The country of source retains a right to tax income that is not dealt with in the other articles of the new DTA. As with the existing DTA, Canada retains a taxing right of up to 15 percent on distributions from Canadian trusts, provided that the distribution is taxed in New Zealand.

Non-discrimination (Article 22)

The OECD model includes an article that prohibits discrimination on the grounds of nationality, situs of an enterprise, ownership of capital, and (in limited circumstances) residence. Article 22 of the new DTA lays down an alternative formulation that we have used in a number of other treaties: this requires that non-residents be treated in a comparable manner to other non-residents, rather than as New Zealand residents. The existing DTA does not include a non-discrimination article.

Other administrative requirements

As was the case with the existing DTA, both countries will have to comply with various administrative requirements imposed by the new DTA. These include a general requirement to eliminate double taxation by giving credits for overseas tax paid (Article 21), complying with the mutual agreement procedures set out in the new DTA (Article 23), and complying with the arrangements for the exchange of information (Article 24).

The new DTA also authorises the New Zealand and Canadian tax authorities to assist each other in the collection of taxes. The article is based on an optional article that was included in the OECD Model Tax Convention in 2002. The existing DTA did not contain any similar provision. New Zealand does not seek the inclusion of this article in all DTAs, but does seek its inclusion in DTAs with countries where it can be expected to give rise to real benefits. This is likely to be the case with Canada.

Dispute resolution mechanisms

Similar to the existing DTA, the new DTA also provides for taxpayer disputes to be resolved through “mutual agreement” by the revenue authorities in both countries. Rather than having to pursue a case through the courts – possibly, in both countries – a taxpayer can approach the local tax authority under the mutual agreement procedure set out in Article 23. If that authority considers the case to be justified, and cannot resolve it through its own actions, it shall seek to do so through mutual agreement with the tax authority of the other country. This bipartisan approach is particularly appropriate in the tax treaty context because a single issue will generally affect a person’s tax position in both countries.

The mutual agreement procedure is not a true disputes resolution mechanism as it does not require both parties to reach agreement. The obligation is for both parties to “endeavour” to resolve the issue. However, the measure is popular with taxpayers as it is a low-cost option for pursuing tax disputes and it requires both parties to reconsider issues in consultation with each other. It remains open to the taxpayer to pursue the matter through the Courts if the outcome of the mutual agreement procedure is unsuccessful (or if they do not agree with the outcome).

The mutual agreement procedure also generally requires the tax authorities of the two countries to endeavour to resolve together any difficulties or doubts about the correct interpretation or application of the new DTA, and allows them to consult together for the elimination of double taxation in cases not provided for in the new DTA.

Reservations

The treaty does not allow parties to make a reservation upon ratification.

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

Subject to the successful completion of the Parliamentary treaty examination process, the new DTA will be incorporated into domestic legislation by Order in Council pursuant to section BH 1 of the Income Tax Act 2007. Section BH 1 authorises the giving of overriding effect to DTAs by Order in Council. The overriding effect is limited to the Inland Revenue Acts, the Official Information Act 1982, and the Privacy Act 1993. The override of the Inland Revenue Acts enables the provisions of the new DTA to provide relief from tax that would otherwise be imposed under domestic law. The override of the Official Information Act is necessary to ensure that confidential communications with the other Contracting State are not required to be disclosed. The override of the Privacy Act is necessary to ensure that information regarding natural persons can be exchanged according to the terms of the treaty.

Article 28 provides for the new DTA to be brought into force through an exchange of diplomatic notes between the Contracting States. The new DTA will enter into force on the date of the last of these notes. New Zealand will be in a position to notify Canada that all procedures required by domestic law have been completed once the Order in Council has entered into force, 28 days after its publication in the Gazette.

The provisions of the new DTA will then have effect from various dates, according to the terms of the new DTA. In New Zealand, the provisions relating to withholding taxes will have effect on or after the first day of the second month following entry into force, and for other taxes for income years beginning on or after 1 April following entry into force. In the case of Canada, the provisions relating to withholding taxes will have effect on or after the first day of the second month following entry into force, and for other taxes the new DTA will have effect for taxable periods beginning on or after 1 January following entry into force.

The only alternative to an Order in Council for implementing a DTA would be by the enactment of a dedicated statute. This is not preferred as it would unnecessarily increase the amount of primary tax legislation.

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

No social, cultural, or environmental effects are anticipated.

As noted in this NIA, the overall economic effects of the new DTA between New Zealand and Canada are expected to be favourable. The new DTA will enhance the existing

investment and trade relationship by ensuring the arrangements governing double taxation between New Zealand and Canada are up-to-date and provide the levels of certainty and protection that taxpayers expect from a modern treaty.

Compliance costs for New Zealand businesses are expected to be reduced as a result of the treaty action. This is because New Zealand businesses will have clearer and more up- to-date guidance about when they will be liable for tax on activities in Canada, in line with internationally recognised norms.

The costs to New Zealand of compliance with the treaty

The principle cost to New Zealand with the new DTA will be the reduction in withholding tax rates on dividends, interest, and royalties. Officials expect that any additional revenue cost (outside the reduction in the withholding tax rates) will be minimal because the new DTA is a replacement of an existing DTA, and the allocation of taxing rights generally remains the same between the new DTA and the existing DTA. Data limitations prevent officials from precisely estimating revenue costs, including, the likely revenue cost of the reduction in withholding tax rates. However, officials estimate the prima facie reduction of tax revenue as a result of the reduced withholding tax rates with Canada to be $0.5 million per annum.

As discussed, the new DTA will be expected to give rise to favourable economic benefits, such as increased trade and investment. Any costs may also be offset by other impacts of the DTA. For example, there will be some offsetting effect to the New Zealand tax base from the reduction of tax in Canada, and the reduced need for New Zealand to allow foreign tax credits. Overall, it is expected that the economic benefits will outweigh the costs.

It has been noted above that the assistance in collection of taxes provisions of the new DTA will result in some administrative costs for Inland Revenue because of the need to collect Canadian taxes. While these costs cannot be quantified precisely, they are expected to be small. Additionally, the arrangement is reciprocal in nature and any costs incurred will likely be offset by the benefits accruing to New Zealand from the ability to ask Canada to collect taxes on our behalf.

Consultation with the community and parties interested in the treaty action

The Ministry of Foreign Affairs and Trade, and the Treasury have been consulted about the terms of the new DTA and the content of this extended NIA and no material concerns were raised. No private sector consultation has been entered into.

Subsequent protocols or amendments to the treaty and their likely effects

No further amendments are anticipated at this time. New Zealand will consider future amendments on a case-by-case basis. Any amendments to the new DTA will be subject to the normal domestic approvals and procedures. While there is no amendment clause in the new DTA, amendment would be subject to the usual requirements of the Vienna Convention on the Law of Treaties.

An accompanying Protocol forms an integral part of the new DTA and will be signed at the same time. Countries often prefer clarifying provisions and departures from their standard treaty model to be located in an accompanying Protocol.

Withdrawal or denunciation provision in the treaty

Under Article 29, either country may terminate the new DTA by giving notice of termination on or before 30 June in any calendar.

In such event, the new DTA will cease to have effect for New Zealand for payments made on, or after, the first day of the second month following the notice of termination (in respect of withholding tax), and for any income year beginning on or after 1 April in the calendar year following the year in which the notice of termination is given (in respect of other New Zealand tax).

The new DTA will cease to have effect for Canada for payments made on, or after, the first day of the second month following the notice of termination (in respect of withholding tax), and for taxation years beginning after the end of the calendar year following the year in which the notice of termination is given (in respect of other Canadian tax).

Agency Disclosure Statement

Inland Revenue has prepared this extended national interest analysis (NIA). It has undertaken an analysis of the issue of implementing the new DTA between Canada and New Zealand and the legislative and regulatory proposals arising from that implementation. As part of that process, it has considered the option of not entering into the treaty. Inland Revenue is of the view that there are no significant constraints, caveats or uncertainties concerning the regulatory analysis. The policy aligns with the Government Statement on Regulation.

The allocation of taxing rights under the new DTA for the most part remains unchanged from the existing DTA. It is broadly consistent with the New Zealand negotiating model, which in turn is based on the OECD's Model Tax Convention. However, withholding tax rates on dividend, interest and royalties have been reduced in line with New Zealand's new, wider strategy on treaty withholding tax rates. The revenue cost to New Zealand as a result of the reduction in withholding rates is expected to be relatively small, at approximately $0.5 million per year.

An Order in Council will be required to give the new DTA effect in New Zealand law. The Order in Council will override the Inland Revenue Acts, the Official Information Act 1982 and the Privacy Act 1993; this is authorised by section BH 1 of the Income Tax Act 2007 and is necessary to give effect to the terms of the new DTA.

The Ministry of Foreign Affairs and Trade, and the Treasury have been consulted about the terms of the new DTA and the content of this extended NIA and no material concerns were raised.

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

ANNEX 2: New Zealand-Canada cross-border investment and trade

Investment

As at 31 March 2011, the total stock of investment between New Zealand and Canada was worth $3.15 billion. Canada is New Zealand's 10th largest investment partner.

New Zealand's total stock of investment in Canada was worth NZ$1.29 billion as at 31 March 2011. This represents 0.8percent of New Zealand's total investment abroad and is comparable to New Zealand's total investment in Hong Kong (NZ$1.2 billion). Of this, NZ$60 million was direct investment and NZ$687 million was portfolio.

The total stock of investment from Canada into New Zealand was worth NZ$1.86 billion as at 31 March 2011. A similar amount has been invested by the People's Republic of China (NZ$1.83 billion). Of this investment by Canada, NZ$1.02 billion was direct, which constitutes 1.1percent of foreign direct investment into New Zealand. NZ$356 million was portfolio investment.

Trade

In the year to June 2011, total bilateral trade between New Zealand and Canada was worth $1.07 billion. This constitutes 1.2 percent of New Zealand's total trade, and is comparable to New Zealand's trade with France (1.2 percent) and Hong Kong (1.0 percent). Canada is currently our 19th largest bilateral trading partner.

Exports to Canada in this period were worth NZ$540 million. This is a 12.8 percent increase over the previous year, although it is a decrease of 7.2 percent since 2001. In the year to June 2011, New Zealand's main exports to Canada were beef meat (NZ$119.5 million) sheep meat (NZ$112.4 million) and wine (NZ$59.2 million). Canada is New Zealand's seventh largest export market for meat products and fourth largest market for wine.

In the same period, New Zealand's imports from Canada were worth NZ$529.7 million. This is a 16.6 percent increase over the previous year, and an increase of 18 percent since 2001. New Zealand's principal imports from Canada consisted of fertilisers (NZ$74 million), pig meat (NZ$35.5 million), and turbine engines (NZ$32.3 million).