International treaty examination of the Agreement between the Government of New Zealand and the Government of the Republic of Singapore 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 conducted an international treaty examination of the Agreement between the Government of New Zealand and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and has no matters to bring to the attention of the House.

The National Interest Analysis for the treaty is appended to this report.

Appendix A

Committee procedure

The committee met on 31 March 2010 to consider the agreement.

Committee members

Craig Foss (Chairperson)
Amy Adams
David Bennett
John Boscawen
Brendon Burns
Hon David Cunliffe
Aaron Gilmore
Raymond Huo
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Appendix B

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

National Interest Analysis

Executive summary

1 The Agreement between New Zealand and the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, and its accompanying Protocol (collectively, "the new Singapore DTA") has been negotiated to replace an existing agreement ("the existing DTA") that dates back to 1973. The existing DTA is framed using antiquated terminology and language, has higher withholding tax rates on interest and royalties than most of New Zealand's other DTAs, and is generally not providing the levels of certainty and protection to businesses that might be expected from a more modern DTA. Given that Singapore is one of New Zealand's more important trading and investment partners, the inadequate nature of the existing DTA has become increasingly problematic over recent years.

2 The new Singapore DTA adopts more modern language and will provide greater certainty for persons engaged in cross-border income earning activity between New Zealand and Singapore. The allocation of taxing rights under the two agreements for the most part remains unchanged. 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 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 the voting power of the company paying the dividend. The interest withholding tax rate will be reduced from 15 percent to 10 percent. In the case of royalties, the withholding tax rate has been reduced from 15 percent to 5 percent. The exchange of information provisions of the new Singapore DTA have been updated to the new OECD standard (this will mean, for example, that information held by banks in Singapore will now be subject to full information exchange). The new Singapore DTA will therefore enhance the ability of tax officials to detect and prevent tax avoidance and evasion. The tax sparing provisions of the existing DTA have been rolled over to the new Singapore DTA, but will terminate after a ten year period.

Date and nature of proposed binding treaty action

3 The new Singapore DTA was signed in Singapore on 21 August 2009. Subsequent to signature and completion of the Parliamentary treaty examination process, it is proposed that the new Singapore DTA be incorporated into domestic legislation through an Order in

Council, and brought into force, in accordance with Article 25, through an exchange of diplomatic notes that confirm completion of all necessary domestic procedures for entry into force in each country. The new Singapore DTA will enter into force on the date of the later of the two diplomatic notes.

4 As Singapore has not completed the necessary legislative reform to give effect to the exchange of information article, the new Singapore DTA contains a provision which allows Singapore to delay entry into force of the exchange of information article until it has completed the necessary legislative reform. In such circumstances the exchange of information provisions of the existing DTA will remain in force for Singapore until the legislative reform is complete, at which point the exchange of information provisions of the new Singapore DTA will enter into force.

Reasons for New Zealand becoming party to the treaty

5 New Zealand currently has 35 double tax agreements ("DTAs") in force. This includes a DTA with Singapore that was negotiated in 1973. DTAs are principally designed to reduce tax impediments to cross-border trade and investment. They do this by providing 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. DTAs also help tax administrations to detect and prevent tax avoidance and tax evasion, primarily by establishing a mechanism through which the tax administrations of the two countries can obtain information (such as tax records, business books and accounts, bank information and ownership information) from each other.

6 Singapore is one of New Zealand's more important trading and investment partners. The latest trade figures available show that in the year to December 2007 New Zealand exported goods worth NZ$690 million to Singapore and Singapore exported goods worth NZ$1.914 billion to New Zealand. Singapore is also an important source of investment for New Zealand, with foreign direct investment from Singapore in 2007 totalling NZ$1.636 billion. With these levels of trade and investment, it is important for New Zealand to have an effective and modern double tax agreement in place with Singapore to facilitate the continuing trade between our two countries.

7 The existing DTA with Singapore, however, is now showing its age. It is currently our second oldest DTA, and is framed using antiquated terminology and language, has higher withholding tax rates on interest and royalties than most of New Zealand's other DTAs, and is generally not providing the levels of certainty and protection to businesses that might be expected from a more modern DTA.

8 The new Singapore DTA will provide increased levels of certainty and protection for tax residents of either country deriving income from the other country. The basic allocation of taxing rights under the two agreements for the most part remains unchanged. However, withholding tax rates on dividend, interest and royalties have been reduced. 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 the voting power of the company paying the dividend. This is consistent with New Zealand's new, wider strategy of seeking to reduce withholding tax rates on non-portfolio dividends in DTAs. The interest withholding tax rate will be reduced from 15

percent to 10 percent. In the case of royalties, the withholding tax rate has been reduced from 15 percent to 5 percent.

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

9 The advantages to New Zealand of the new Singapore DTA entering into force are:

- DTAs are generally designed to foster increased trade and investment. Singapore is a key trading and investment partner. It is important to New Zealand's interests that the DTA between New Zealand and Singapore remains up to date and relevant to the prevailing business environment. The new Singapore DTA will update existing arrangements to ensure that the DTA provides modern levels of certainty and protection with respect to cross-border income earning activities between the two countries. In particular, the fact that the provisions of the DTA now substantively follow those of the OECD Model Tax Convention will mean that the Commentary to the OECD Model will apply. This will facilitate improved consistency in the interpretation and application of the DTA provisions.

- The allocation of taxing rights under the new Singapore DTA largely remains unchanged from existing arrangements. However, withholding taxes on dividend, interest and royalties will be reduced to be more in line with New Zealand's new standard DTA rates. 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 the voting power of the company paying the dividend. The interest withholding tax rate will be reduced from 15 percent to 10 percent. In the case of royalties, the withholding tax rate has been reduced from 15 percent to 5 percent. The new Singapore DTA has anti-abuse provisions which are aimed at preventing persons who are not entitled to the low treaty withholding tax rates from gaining access to those low rates.

- Tax administrations are privy to sensitive financial and personal information. This information is held subject to strict confidentiality requirements. DTAs override these confidentiality rules and ensure that tax administrations can request from each other information that will assist in the prevention of tax evasion and tax avoidance. The new Singapore DTA improves the existing information exchange arrangements with Singapore, in that the new Singapore DTA now allows for total unrestricted exchange of information. This will allow New Zealand access to information that had previously had been denied under the existing DTA. In particular, New Zealand is now able to request bank information from Singapore. Note that information obtained under DTAs remains protected, as it can only be disclosed to specified persons and may only be used for authorised purposes.

- The existing DTA contains "tax sparing" provisions. It was entered into at a time when New Zealand DTA policy was to include tax sparing concessions in DTAs with developing countries. Singapore at that time was a developing country. The practice of taxing residents on their worldwide income can nullify tax concessions offered by developing nations to attract inward investment. An investor pays less foreign tax because of the concession, but also gets a smaller credit to set against their home tax liability. As a result, the tax foregone ("spared") by the developing nation is effectively clawed back by the state in which the investor is resident.[1] The tax sparing provisions in the existing DTA counteract this by requiring New Zealand to give a credit as if foreign tax had in fact been paid. For a number of reasons, New Zealand has a policy of no longer including tax sparing provisions in its DTAs. The new Singapore DTA imposes an end date on the existing tax sparing arrangements. After ten years, the tax sparing arrangements will expire. The new Singapore DTA therefore terminates the existing tax sparing arrangements (after ten years).

10 The disadvantages to New Zealand of the new Singapore DTA entering into force are:

- New Zealand will forgo some revenue from the reduction in withholding tax in dividend, interest and royalties. This revenue cost will be offset to some extent by the reciprocal reduction of Singapore's withholding taxes on interest and royalties derived by New Zealand residents from Singapore, and the resulting reduced need for New Zealand to provide foreign tax credits. However, as investment from Singapore into New Zealand exceeds investment from New Zealand into Singapore, New Zealand will suffer a net revenue loss.
- The new Singapore DTA includes an obligation on New Zealand, if we ever agree to lower withholding tax rates on dividends, interests and royalties in another DTA, to re-enter negotiations with Singapore with a view to amending the new Singapore DTA to include similar lower rates. Thus, the contingent obligation on New Zealand may potentially lead to further reductions in withholding tax rates in the new Singapore DTA, and consequently to a further reduction in New Zealand revenue.[2]

11 Not signing or otherwise progressing the new Singapore DTA to entry into force is an option. However, in that case the potential benefits to New Zealand in terms of a modernised tax treaty, increased certainty of tax treatment, unrestricted information exchange, and a cap on New Zealand's obligations to provide tax sparing credits, will be foregone. Also the current very high withholding rates on interest and royalties will continue to apply.

12 On balance, it is in New Zealand's interest to conclude the new Singapore DTA.

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1 New Zealand's international taxation rules are currently being amended to exempt the offshore active income of controlled foreign companies. This will reduce the "claw-back" effect of New Zealand's taxation rules, and may make tax sparing a less significant issue for New Zealand in the future.

2 It will be unlikely that the MFN clause will be triggered in the near future as the withholding tax rates in the new Singapore DTA are generally in line with New Zealand's new treaty policy.

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

13 The new Singapore DTA will not impose 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. The new Singapore DTA will not require the imposition of a tax that is not already imposed under domestic law.

14 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 Singapore DTA. The main impact of a 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, a 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 Singapore DTA are essentially unchanged from the existing DTA. They provide as follows:

- *Business profits*

Income from "immovable property"[3] will always be taxable in the country of source if the property is situated in that country. (Article 6 of the new Singapore DTA refers.)

Profits from the operation of ships or aircraft will not be taxable in the country of source except in respect of operations conducted solely within that country. The carriage of passengers or cargo between ports in a country, even when forming part of a longer international voyage by the ship or aircraft concerned, will be considered to be operations conducted solely within a country. (Article 8 of the new Singapore DTA refers.)

Otherwise, business profits will only be taxable in the country of source when derived through a "permanent establishment"[4] situated in that country. (Article 7 of the new Singapore DTA refers.)

The new Singapore DTA does not affect the ability of the country of residence to tax any of these categories of income.

- *Investment income*

Dividends will generally remain taxable in the country of source, but the tax imposed by that country may not exceed 5 percent of the gross amount of the dividends if the recipient of that dividend is a company that owns at least 10 percent of the voting power of the company that is paying the dividends and 15 percent for all other dividends. (Article 10 of the new Singapore DTA refers.)

[3] The term "immovable property" is widely used in DTAs in preference to the comparable term "real property".

[4] The term "permanent establishment" is defined in Article 5. It generally means a fixed place of business through which the business of an enterprise is carried on.

Interest will generally remain taxable in the country of source, but the tax imposed by that country may not exceed 10 percent of the gross amount of the interest. (Article 11 of the new Singapore DTA refers.)

Royalties will generally remain taxable in the country of source, but the tax imposed in that country may not exceed 5 percent of the gross amount of the royalties. (Article 12 of the new Singapore DTA refers.)

The new Singapore DTA does not affect the ability of the country of residence to tax any of these categories of income.

- *Gains from the alienation of property*

Gains from the alienation of property will always be taxable in the country of source, except for gains from the alienation of ships or aircraft operated in international traffic which remain taxable only in the country of residence. (Article 13 of the new Singapore DTA refers.)

The new Singapore DTA does not affect the ability of the country of residence to tax gains from the alienation of property.

- *Income from personal services*

Directors' fees will be taxable in the country of source, provided that the company paying the director's fees is resident in that country. (Article 15 of the new Singapore DTA refers.) The new Singapore DTA does not affect the ability of the country of residence to tax the income.

Income derived from activity as an entertainer or sportsperson will always be taxable in the country of source if the income-earning activities take place in that country. (Article 16 of the Singapore DTA refers.) The new Singapore DTA does not affect the ability of the country of residence to tax the income.

Salaries and wages relating to Government service are taxable only in the country of source. (Article 18 of the new Singapore DTA refers.)

Otherwise, income from employment will not be taxable in the country of source unless the employment is performed in that country, the employee is present in that country for at least 183 days in any 12 month period, and various other conditions are met. (Article 14 of the new Singapore DTA refers.)

The new Singapore DTA will not affect the fiscal privileges of members of diplomatic missions or consular posts.

Except for salaries and wages relating to Government service, the new Singapore DTA does not affect the ability of the country of residence to tax any of these categories of income.

- *Other income*

Government service pensions are taxable only in the country of source. Otherwise, pensions are taxable only in the country of residence. (Articles 17 and 18 of the new Singapore DTA refer.)

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. (Article 19 of the Singapore DTA refers.)

Income not otherwise dealt with under the new Singapore DTA remains taxable in both the country of source and the country of residence. (Article 20 of the new Singapore DTA refers.)

15 Where, under the above rules, income is taxable both in the country of residence and the country of source, the country of residence is required to relieve the double taxation by providing a credit for the tax paid in the country of source. (Article 21 of the new Singapore DTA refers.) In the case of New Zealand, the crediting mechanism imposed by the new Singapore DTA is consistent with the foreign tax credit provisions at subpart LJ of the Income Tax Act 2007.

16 The new Singapore DTA contains a mutual agreement procedure, under which the "competent authority"[5] of each country may endeavour to resolve difficulties or doubts as to the interpretation or application of the new Singapore DTA. The mutual agreement procedure also serves as a limited disputes resolution mechanism for anyone who considers that the provisions of the new Singapore DTA are not being applied to them correctly. They may present a case to the competent authority of their respective country. The competent authority is required to endeavour to resolve the problem, either alone or by mutual agreement with the competent authority of the other country. (Article 22 of the new Singapore DTA refers.) Note that the mutual agreement procedure does not always successfully resolve disputes, because the two competent authorities may not actually be able to agree on a solution. However, the person concerned retains the right to pursue disputes through the Courts.

17 The new Singapore DTA requires the tax administrations of each country to assist each other in the detection and prevention of tax evasion and avoidance by facilitating exchanges of information on tax matters. (Article 23 of the new Singapore DTA refers.) Exchanged information typically consists of tax records, business books and accounts, bank information and ownership information.

[5] The "competent authority" is a person nominated by a DTA to carry out certain functions of a DTA. In the case of New Zealand, the competent authority under the Singapore DTA is the Commissioner of Inland Revenue or an authorised representative.

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

18 Section BH 1 of the Income Tax Act 2007 enables DTAs to be given effect by Order in Council. Section BH 1 provides that DTAs will then override the Inland Revenue Acts, the Official Information Act 1982, the Privacy Act 1993, although generally only in relation to income tax. (The key exception is for the exchange of information, which may apply in relation to taxes other than income tax.) The override of the Inland Revenue Acts is necessary to give effect to the terms of a DTA (for example, DTAs require New Zealand to forego some taxing rights imposed under those Acts). The Official Information Act is overridden to ensure that communications with other states during DTA negotiations are not disclosed. The Privacy Act is overridden to ensure that information can be exchanged regarding natural persons under the exchange of information provisions.

19 Subject to completion of Parliamentary treaty examination, the Order in Council will be promulgated and will come into effect 28 days after being published in the Gazette.

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

20 The main economic effect of the new Singapore DTA will be to increase certainty of tax treatment and reduce compliance costs for New Zealand businesses that operate in Singapore and vice versa. The new Singapore DTA will also reduce withholding taxes on dividends, interest and royalties. This will result in a tax revenue loss to New Zealand. However, it is also anticipated that the lower rates will facilitate increased trade and investment flows between New Zealand, and that over time the benefits to New Zealand will outweigh the lost revenue.

21 No social, cultural or environmental effects are anticipated.

Costs to New Zealand of compliance with the treaty

22 DTAs generally require New Zealand to forgo some revenue from the limitation of our taxing rights on cross-border income that we are currently able to tax. The new Singapore DTA, however, replaces an existing DTA. In the majority of cases, the allocation of taxing rights under the existing DTA remain unchanged. The principle cost to New Zealand of compliance with the new Singapore DTA will therefore be the reduction in withholding tax rates on dividend, interest and royalties (paragraph 12 above discusses the new withholding tax rates in detail).

23 The reduction in withholding tax rates is reciprocal on both countries. To the extent that the lower withholding tax rates will result in reduced Singapore tax, the New Zealand tax base will benefit through a reduction in foreign tax credits.

24 To the extent that the cost to the New Zealand revenue from lowering withholding tax rates is not offset by a reduction in creditable Singaporean tax, it is expected that the economic benefits of the new Singapore DTA will outweigh these costs.

Consultation

25 The Treasury and the Ministry of Foreign Affairs and Trade have been consulted on and agree with the proposed treaty action.

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

26 Any subsequent amendment to the new Singapore DTA will be by Protocol. No specific amendments to the new Singapore DTA are contemplated. However, New Zealand has agreed to include an obligation in the new Singapore DTA that will apply if New Zealand ever agrees to lower withholding tax rates on dividends, interests and royalties in another DTA. New Zealand will then be obliged to offer to re-enter negotiations with Singapore with a view to amending the new Singapore DTA to include similar lower rates. Otherwise, any proposed amendments will be considered on a case-by-case basis and any decision to proceed with an amendment will be subject to normal domestic approvals and procedures.

Withdrawal or denunciation provision in the treaty

27 Article 26 of the new Singapore DTA provides that, after the expiration of five years from the date of entry into force, either New Zealand or Singapore may terminate the DTA. Notice of termination is to be made through diplomatic channels and must be given at least six months before the end of the calendar year in which it is made.

Adequacy statement

28 Inland Revenue has prepared this extended national interest analysis and has assessed it as adequate in accordance with the Code of Good Regulatory Practice.