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

Recommendation

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

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

Appendix A

Committee procedure

The committee met on 28 July and 4 and 18 August 2010 to consider the agreement.

Committee members

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

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

National Interest Analysis

Executive summary

Negotiations have been successfully completed for an Agreement between the Government of the Republic of Turkey and the Government of 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, "the DTA").

The DTA will provide greater certainty in the taxation of cross-border investment income, reduce compliance costs and set limits for withholding taxes on dividends, interest and royalties. It is also expected to enhance cross-border trade and investment and will assist in the prevention of fiscal avoidance and evasion. To the extent that the revenue cost of the DTA to New Zealand is not fully offset by a reduction in creditable Turkish tax, we would expect the economic benefits to outweigh the costs. It is therefore considered that the DTA is in New Zealand's interests.

Nature and timing of proposed binding treaty action

The Agreement between the Government of the Republic of Turkey and the Government of New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and its accompanying Protocol was signed in Ankara on 22 April 2010. It was signed in English and Turkish, both texts having equal authority. The English text of the DTA is attached as an Annex to this paper.

Subsequent to signature and completion of the Parliamentary treaty examination process, in accordance with Standing Orders 388 to 391, the DTA will be incorporated into domestic legislation through an Order in Council. In accordance with Article 28 of the DTA, the DTA will 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 DTA will enter into force on the date of the later of these notes. It is expected that Parliamentary treaty examination will be completed by the end of 2010.

The DTA will not apply to Tokelau, the Cook Islands or Niue.

Reasons for New Zealand to take the treaty action

Double tax agreements are bilateral international treaties principally designed to encourage growth in economic ties between countries. They do this by reducing tax impediments to cross-border trade and investment. More specifically, they provide greater certainty of tax

treatment, share the cost of relieving double taxation, limit withholding taxes on cross-border investment returns, and exempt certain short-term activities in the host State from tax in that State.

Double tax agreements also enable the tax administrations of each country to assist each other in the detection and prevention of tax avoidance and evasion. They do this primarily by establishing a mechanism by which the two tax administrations can exchange certain tax-related information (such as tax records, business books and accounts, bank information and ownership information) with each other. The tax authorities can use the information they obtain under the treaty to determine if residents are correctly reporting overseas income and to identify tax avoidance schemes. New Zealand's domestic law specifically prohibits Inland Revenue from divulging information it holds to foreign jurisdictions unless this is authorised by a tax treaty (sections 81 and 88 of the Tax Administration Act 1994).

More recently, double tax agreements have also begun to include provisions that enable tax authorities to assist each other in the collection of unpaid taxes. The DTA with Turkey includes such provisions, providing a mechanism whereby tax can be recovered from taxpayers who move overseas.

Relevant factors in considering whether to conclude a double tax agreement with a given country include the strength of political relationship with that country and the strength of existing or potential trade relationships. Relations between Turkey and New Zealand have developed steadily over the past few years, including the establishments of a Joint Economic Commission to promote trade and other economic activity.

Turkey was New Zealand's 51st most important bilateral trading partner in the year ending June 2009, with total trade valued at NZ$160 million (0.2% of total New Zealand trade). Imports stood at NZ$51 million and exports at NZ$109 million. In the short term, the areas of greatest potential for New Zealand companies in the Turkish market are likely to be services, high technology and specialised manufacturing.

Turkey's membership of the OECD is relevant to the decision to conclude the DTA. As a full member of the OECD, New Zealand has an implied obligation (although not necessarily a legal obligation) to follow the recommendation made by the OECD to member countries to pursue efforts to conclude bilateral tax conventions with those member countries, and where appropriate with non-member countries, with which they have not entered into such conventions, and to revise those of the existing conventions that may no longer reflect present day needs.

Advantages and disadvantages to New Zealand of the treaty action

The advantages to New Zealand of the DTA entering into force are as follows:

- It will remove tax impediments to cross-border transactions between New Zealand and Turkey. In particular, it shares the cost of relieving the double taxation of income. The DTA will regulate how transactions should be taxed between the two countries.
- It will set limits for withholding taxes on dividends, interest and royalties.

- When both countries are permitted to tax the same income in the hands of the same person, it will ensure that the country of residence allows a credit or exemption for the tax paid in the country of source.
- It will provide taxpayers with greater certainty of tax treatment, along with a mutual agreement procedure for resolving disputed issues that may arise in relation to the DTA.
- It will assist the tax administrations of both countries and help to prevent the avoidance and evasion of taxes by facilitating the exchange of information and allowing for assistance in the collection of taxes.

The disadvantages to New Zealand of the DTA entering into force are as follows:

- New Zealand may forgo some revenue because of limits imposed on withholding taxes and the allocation of taxing rights over some income wholly to Turkey. 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 Turkish tax is correspondingly reduced or eliminated under the DTA.
- The requirement for New Zealand to provide Turkey with information and assistance under the exchange of information and assistance in collection of taxes provisions of the DTA will involve some additional administrative costs for Inland Revenue, although these are expected to be small. Again, the ability to request information or seek assistance is reciprocal.

It would be an option for New Zealand not to enter into the DTA with Turkey. If that option were adopted, the benefits outlined above would not be realised. There is no practical alternative to a double tax agreement for achieving the desired outcomes.

On balance, it is considered to be in New Zealand’s interests to conclude the DTA with Turkey. It is expected to enhance cross-border trade and investment and will assist in the prevention of fiscal avoidance and evasion.

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

The DTA does not impose requirements on taxpayers. The obligations it imposes are on the Contracting States, restricting their taxing rights on a reciprocal basis and requiring exchange of information and assistance in the collection of taxes.

New Zealand taxes its residents on their worldwide income. Non-residents are taxed only on their New Zealand-sourced income. Turkey has a similar system (in some circumstances, it may also tax the worldwide income of non-resident nationals). The two systems therefore potentially overlap, giving rise to the possibility of juridical double taxation. Juridical double taxation typically arises when the country of which the person deriving income is a resident and the country from which the income is derived both tax the same item of income in the hands of that person.

The DTA seeks to prevent juridical double taxation by allocating taxing rights between the Contracting States. The rules with which New Zealand and Turkey will be required to

comply when imposing tax on residents of either country are outlined below. Subsequent paragraphs provide more detail on key issues.

- Income from immovable property will generally be taxed in the country in which the property is situated (Article 6).
- Business profits of an enterprise will be taxable only in the country of which the enterprise is a resident unless profits are derived through a permanent establishment in the other country (Article 7). In that case, the profits may be taxed in that other country. A permanent establishment generally exists when there is a fixed place in a country through which the business of an enterprise is carried on.
- Profits of an enterprise of a country from the operation of ships or aircraft in international traffic will be taxable only in that country. However the DTA ensures that the taxation of domestic carriage will be taxed on the same basis as any other business (Article 8).
- Dividends, interest and royalties may generally be taxed in both countries (Articles 10, 11 and 12). However, the country in which such payments arise may not impose tax in excess of specified limits.
- Gains from the sale of immovable property will be taxable in the country in which the property is situated (Article 13). Gains from the sale of moveable property will generally be taxable in the country where the vendor is resident, except when the property is the business property of a permanent establishment in the other country.
- Income from services will be taxable only in the country of which the enterprise or person deriving the income is a resident, unless there is either a permanent establishment or fixed base in the other country or the services are performed in that other country for more than 183 days in any 12-month period (Article 14).
- 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 (Article 15). In such case, the country in which the employment is performed may also tax the income if the employee is present there for 183 days in any 12-month period and certain other conditions are met.
- Directors' fees will be taxable in the country where the company paying the fees is resident (Article 16).
- Income from the activities of entertainers (artistes) and sportspersons may generally be taxed in the country in which those activities are performed (Article 17).
- Pensions will only be taxable in the country where the recipient is resident (Article 18).
- Salaries and wages for services to a Government of one country will generally be exempt from tax in the other country (Article 19).
- Students and apprentices from one country living in the other country will not generally be taxed on payments received from outside that other country if those payments are for maintenance or education (Article 20). Employment income earned while a person is obtaining practical experience relating to their studies may also be exempt.

In addition, both countries will have to comply with various administrative requirements imposed by the DTA. These include a general requirement to eliminate double taxation by giving credits for overseas tax paid (Article 22), not enacting tax laws that discriminate against residents of the other country vis-à-vis residents of any other state (Article 23), complying with the mutual agreement procedures set out in the DTA (Article 24), and complying with the arrangements for the exchange of information (Article 25) and assistance in the collection of taxes (Article 26).

Income from services

New Zealand's general treaty practice is to include a bright-line (non-OECD) rule allowing a country to tax income from services (such as professional services) if the person or enterprise performing the service has been present there for at least 183 days in any 12-month period. This strengthens source taxation by removing the need to establish the existence of a permanent establishment or fixed base, which can sometimes be difficult. The DTA includes an equivalent rule in Article 14, which deals with independent personal services.

Non-resident withholding tax

A key effect of the DTA is to limit the rate of withholding tax that can be imposed on dividends, interest and royalties by the country in which those payments arise.

Article 10 of the DTA limits the rate of withholding tax on dividends on a reciprocal basis to 5% if the dividend goes to a company owning at least 25% of the company making the distribution (provided the dividend is exempt in the other State), and in all other cases the rate is 15%. Most foreign dividends received by companies are now exempt, so New Zealand companies receiving dividends from Turkish subsidiaries can qualify for the reduced rate of 5%. In other tax treaties (with Australia, Singapore and the United States), the threshold for the 5% rate was set at a lower level (10% ownership of the company paying the dividend). The treaties with Australia and the United States also included a zero rate for companies owning at least 80% of the company paying the dividend and meeting certain other criteria. However, 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.

Article 11 of the DTA limits the rate of withholding tax on interest on a reciprocal basis to 10% for interest paid to a bank and to 15% in all other cases. New Zealand's tax treaties generally limit withholding tax on interest to 10%, rather than 15%. However, a 15% limit is included in a few existing treaties. As a net capital importer, this higher limit is not of particular concern to New Zealand.

Article 12 of the DTA limits the rate of withholding tax on royalties on a reciprocal basis to 10%. This is consistent with New Zealand's general treaty practice, although we have reduced the rate to 5% in some recent agreements. The DTA also provides a broad definition of "royalties", strengthening source taxation. Although the definition is not exactly the same as that used in New Zealand's model, the key elements are there.

Alienation of property

In Article 13, dealing with the alienation of property, New Zealand's model differs from the OECD model by referring to "income" derived from such disposals as well as "gains". The references to income ensure, in particular, that amounts derived from the sale of immovable property may always be taxed by the country in which that property is situated, even if the property is on revenue account. (Land and buildings may be on revenue account if, for example, they are bought and sold by a property speculator.) The DTA follows the OECD model in referring in this article only to gains from property disposals. This is an unusual departure from the New Zealand model, but not unprecedented. At the margins, it may limit the taxing rights of the country in which property is situated, on a reciprocal basis. The associated fiscal impact is expected to be small.

Artistes & sportspersons

In line with the OECD and New Zealand models, the DTA includes special rules allowing a country to tax entertainers (artistes) and sportspersons for performances within its jurisdiction, even if the person is only present there for a very short period (Article 17). This recognises that such persons can earn large fees within a short space of time. The DTA includes a special exemption from source country taxation for activities supported wholly or mainly from public funds. While this (non-OECD) measure is not something normally included in our treaties, it is consistent with the general approach of giving special recognition to activities or payments funded by foreign governments. The exemption applies on a reciprocal basis and the associated fiscal impact is expected to be small.

Students

In line with the OECD and New Zealand models, the DTA includes special rules for students and business apprentices from a Contracting State (Article 20). If they are studying or training in the other country, any payments for maintenance, education or training arising outside that country may not be taxed there. Article 20 includes a technical variation on our usual treaty practice, to ensure that the provision can apply to nationals of a Contracting State even if they spent time in a third country before commencing their studies/training. It also includes a source-country exemption for employment income earned while a person obtains practical experience (this can apply for up to two years).

Non-discrimination

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 23 of the 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. It also includes a most favoured nation (MFN) clause that commits New Zealand to renegotiating the article if we include an OECD-style non-discrimination article in a subsequent treaty with another State.

Dispute resolution mechanisms

Tax treaties routinely provide for taxpayer disputes to be resolved through "mutual agreement" by the revenue authorities in both countries. This DTA is no exception. 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 24. 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 also 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 DTA, and allows them to consult together for the elimination of double taxation in cases not provided for in the DTA.

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

Subject to the successful completion of the Parliamentary treaty examination process, the 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 double tax agreements by Order in Council. The Order in Council may (and will) specify that the provisions of the DTA have effect in relation to tax matters notwithstanding any provision of the Inland Revenue Acts, the Official Information Act 1982 or the Privacy Act 1993. The override of the Inland Revenue Acts is necessary to give effect to the core provisions of the DTA, which may 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 do not have 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 DTA to be brought into force through an exchange of diplomatic notes between the Contracting States. The DTA will enter into force on the date of the last of these notes. New Zealand will be in a position to notify Turkey 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.

Thereafter, the provisions of the DTA will have effect from various dates, according to the terms of the DTA. In New Zealand, the provisions relating to withholding taxes will have effect from the beginning of the calendar year 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 Turkey, the provisions of the DTA will have effect for taxable periods beginning on or after 1 January following entry into force. Provisions dealing with assistance in the collection of taxes will have effect from a date to be agreed in a subsequent exchange of diplomatic notes.

There is no alternative to an Order in Council for implementing a double tax agreement.

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

No social, cultural or environmental effects are anticipated. Any economic effects are expected to be favourable, as noted above.

The costs to New Zealand of compliance with the treaty

New Zealand will forgo some revenue from the limitation of our taxing rights, as outlined above. This will mean that we are not able to tax some income that is currently taxed under domestic law, and that the rate of tax that can be imposed on certain other income will be reduced. The revenue cost will include tax forgone in relation to short-term activities of Turkish residents in New Zealand, which the DTA will exempt from New Zealand tax. It may also reflect reduced tax on royalties derived from New Zealand by residents of Turkey, in respect of which the DTA will restrict withholding tax rates to 10% (the domestic law rate being 15%). There may also be some revenue cost from reduced withholding tax rates on dividends and interest derived from New Zealand by residents of Turkey, although that tax is already largely relieved under domestic law.

Turkey will be similarly constrained in terms of the tax it can impose on income derived by residents of New Zealand. This reduced foreign tax will tend to flow through to the New Zealand tax base through a reduction in credits for foreign tax paid. In addition, the DTA will enhance our ability to detect and prevent tax avoidance and tax evasion.

Finally, the DTA will generally give rise to favourable economic benefits (such as increased trade and investment). To the extent that the cost to the New Zealand revenue is not fully offset by the reduction in creditable Turkish tax, we would expect that the economic benefits of the DTA will outweigh the costs.

The provisions of the DTA concerning the exchange of information and assistance in collection of taxes will involve some additional administrative costs for Inland Revenue, although these are expected to be small and the ability to request information or seek assistance is reciprocal.

Completed or proposed 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 DTA and the content of this extended national interest analysis 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

The DTA includes a MFN clause (paragraph 11 of the Protocol) in respect of the non-discrimination article. This commits New Zealand to renegotiating the article if we include an OECD-style non-discrimination article in a subsequent treaty with another State. The likely outcome would be to amend the DTA to prohibit discrimination on the grounds of nationality, situs of an enterprise, ownership of capital, and (in limited circumstances) residence. In its current form, the DTA has a more limited non-discrimination article which only requires that non-residents are treated in a comparable manner to other non-residents, rather than as a New Zealand resident.

No further amendments are anticipated at this time. New Zealand would consider future amendments on a case-by-case basis. Any amendments to the DTA, including amendments pursuant to the MFN clause described above, would be subject to the normal domestic approvals and procedures. While there is no amendment clause in the 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 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 Party may terminate the DTA by giving notice of termination on or before 30 June in any calendar year beginning after the expiration of 5 years from the date of its entry into force. In such event, the DTA will cease to have effect for New Zealand either after 1 January or 1 April the following year depending on the tax in question.

Agency disclosure statement

Inland Revenue has prepared this extended national interest analysis. It has undertaken an analysis of the issue of implementing the DTA between Turkey 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.

An Order in Council will be required to give the DTA effect in New Zealand law. The DTA represents a good outcome for New Zealand. It is broadly consistent with the New Zealand negotiating model, which in turn is based on the OECD's model. The DTA is expected to enhance cross-border trade and investment and will assist in the prevention of fiscal evasion and avoidance.

The Ministry of Foreign Affairs and Trade and the Treasury have been consulted about the terms of the DTA and the content of this extended national interest analysis 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 (as referenced in chapter 3 of the Legislation Advisory Committee Guidelines).

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 DTA.

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