Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Policy report: Timeline for BEPS-related tax policy work

Date:	14 November 2014	**Priority:**	Medium
Security level:	In Confidence	**Report no:**	IR2014/531

Action sought

	Action sought	**Deadline**
Minister of Revenue	**Agree** to the recommendations in this report and **refer** a copy of the report to the Minister of Finance	None

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
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14 November 2014

Minister of Revenue

Timeline for BEPS-related tax policy work

Executive summary

In August 2014, we reported to you on the progress of the G20/OECD BEPS Action Plan ("Action Plan") (T2014/1412; IR 2014/366 refers). That report was our fourth tax policy report on the OECD's base erosion and profit shifting ("BEPS") work, and was provided to you just prior to the release of the first set of deliverables under the Action Plan in September 2014. It summarises the OECD's progress under the Action Plan on an item-by-item basis and the implications of the work for potential domestic law reform. We have attached a copy of that report as appendix B for your information.

The purpose of this report is to provide you with an expected timeline for the BEPS-related work that is on the tax policy work programme, lined up against the OECD's timeline for the release of its work under relevant items of the Action Plan. It does not provide you with any additional information on the substance of the OECD's work or the implications of that work on potential domestic law reform (on which there are no significant developments to report).

More specifically, this report provides a timeline for:

- Planned release dates of OECD work;
- Planned release dates of New Zealand public consultation documents; and
- Planned introduction dates of associated legislation.

A summary table of the information provided is included as appendix A to this report.

New Zealand has been actively involved in the OECD's BEPS work, particularly in areas where the OECD's recommendations will affect New Zealand without changes to our domestic rules (for example, under the action items concerning tax treaty abuse, transfer pricing, and GST and the cross-border supply of services, intangibles, and goods), as well as in areas that we expect to be important in terms of guiding our future domestic law reform programme.

As regards to those recommendations that will affect New Zealand without changes to our domestic rules, we note that the Digital Economy Task Force (under Action 1 of the Action

Plan) and the OECD's Working Party 9 on Consumption Taxes are releasing a discussion consultation document on services and intangibles in December, and we intend to report to you on this following this month's Working Party 9 meeting at the OECD, before the planned release of that consultation document.

While New Zealand's international tax policy settings are generally robust, there are areas in which New Zealand is actively considering reform to its domestic rules to line up with the OECD's recommendations under the Action Plan. These areas are:

- Neutralise the effects of hybrid mismatch arrangements (Action 2); and
- Limit base erosion via interest deductions (Action 4).

The OECD work in these areas will be finalised as part of the whole Action Plan package at the end of 2015. Our aim is to release consultation papers in late 2015 regarding potential domestic law reform in these areas following the conclusion of the OECD's work. The advantage of waiting for the OECD work to be finalised is that it will ensure any New Zealand initiatives are guided by the approaches recommended by the OECD.

There are also areas of work, although not specific to action items under the Action Plan, in which New Zealand's current international tax settings could be improved to address BEPS concerns. These areas include:

- Reviewing the taxation of foreign trusts;
- Strengthening non-resident withholding tax ("NRWT") rules; and
- Improving the quality and usefulness of tax information via administrative measures ("BEPS Compliance Measures").

We intend to report to you regarding a review of the rules for taxing foreign trusts prior to the end of the year. Regarding the projects on strengthening the NRWT rules and BEPS Compliance Measures, we expect to release consultation documents by mid-2015. These can be released prior to the finalisation of the OECD's work under the Action Plan, because the recommendations coming out of the Action Plan do not specifically address these matters.

Another related area of work which will have domestic implications is the G20's automatic exchange of information initiative (on which we last reported to you on 15 October 2014 (refer IR2014/485)).

Inland Revenue and Treasury officials will continue to attend OECD meetings on BEPS – particularly those meetings on action items that are relevant to the BEPS concerns that are important to New Zealand. This includes some or all of the meetings of the following working parties (and related focus groups):

- Working Party 1 on Tax Treaties;
- Working Party 6 on the Taxation of Multinational Enterprises;
- Working Party 9 on Consumption Taxes;
- Working Party 10 on Exchange of Information and Tax Compliance;
- Working Party 11 on Aggressive Tax Planning; and
- Committee of Fiscal Affairs.

We will keep you informed on important developments that arise from these meetings.

In tandem with this work, we are continuing to update our international tax treaty network, and we have included the double tax agreement, tax information exchange agreement, and air transport agreement negotiations planned for 2015 in this report.

Three previous reports by officials on the OECD's BEPS work have been publically released (T2012/3250; PAD2012/268, T2013/927; PAS2013/63; T2013/2059; PAS2013/152). You may wish to consider publically releasing this report, and the report attached as appendix B.

We recommend that you refer a copy of this report to the Minister of Finance for his information.

Recommended action

We recommend that you:

(a) **Agree** to the timelines for BEPS-related reforms.

Agreed/Not agreed

(b) **Consider** whether to release this report and the previous BEPS report provided to you in August 2014 (and attached as appendix B to this report) (T2014/1412; IR2014/366 refers).

Considered

(c) **Refer** a copy of this report to the Minister of Finance.

Referred

Carmel Peters
Policy Manager
Policy and Strategy
Inland Revenue

Hon Todd McClay
Minister of Revenue

Background

1. We last reported to you on 19 August 2014 on the progress of OECD's BEPS work under the Action Plan, and the implications of that work on potential domestic law reform. That report was the fourth tax policy report that we have provided regarding the OECD's BEPS work ("Fourth BEPS Report"), and was provided just prior to the release of the first set of deliverables under the Action Plan in September 2014. The remaining Action Plan deliverables are due for release in September and December 2015.

2. We attach a copy of the Fourth BEPS Report (T2014/1412; IR2014/366) for your information as appendix B.

3. We have also previously reported to you on the related G20's automatic exchange of information ("AEOI") initiative; most recently on 15 October 2014 (refer IR2014/485).

4. New Zealand has been actively involved in the OECD's BEPS work, particularly in areas where the OECD's recommendations will affect New Zealand without changes to our domestic rules (for example, under the action items concerning tax treaty abuse, transfer pricing, and GST and the cross-border supply of services, intangibles, and goods), as well as in areas that we expect to be important in terms of guiding our future domestic law reform programme.

5. With regard to our future domestic law reform programme, this report provides you with an expected timeline for BEPS-related work, lined up against the OECD's timeline for the release of its work under relevant items of the Action Plan. This work either:

- Directly relates to an action item under the Action Plan; or
- Is an area of work that, although not specific to an action item, requires attention to address BEPS concerns; or
- Otherwise relates to the OECD's BEPS work.

6. In tandem with this work, we continue to work on updating our international tax treaty network, and we have included in this report the double tax agreement ("DTA"), tax information exchange agreement ("TIEA") and air transport agreement negotiations planned for 2015.

OECD timeline for deliverables under the Action Plan

7. As noted in the Fourth BEPS Report, the OECD released its first set of deliverables under the Action Plan ahead of the G20 Finance Ministers' meeting, in September 2014. The papers released in September 2014 covered are:

- Tax challenges of the digital economy (Action 1);

- Hybrid mismatch arrangements (Action 2);
- Counter harmful tax practices more effectively (Action 5) (interim report);
- Preventing treaty abuse (Action 6);
- Modifications of the OECD Transfer Pricing Guidelines related to transfer pricing aspects of intangibles (Action 8);
- Modifications of the OECD Transfer Pricing Guidelines related to documentation (Action 13); and
- Develop a multilateral instrument to modify bilateral tax treaties (Action 15).

8. The remaining Action Plan deliverables are due for release in September and December 2015. The action items to be covered are as follows:

September 2015

- Strengthen Controlled Foreign Companies ("CFC") rules (Action 3);
- Limit base erosion via interest deductions (Action 4);
- Counter harmful tax practices more effectively (Action 5);
- Prevent the artificial avoidance of permanent establishment status (Action 7);
- Transfer pricing in relation to risks and capital, and other high-risk transactions (Actions 9 and 10);
- Establish methodologies to collect and analyse data on BEPS and the actions to address it (Action 11);
- Require disclosure of aggressive tax planning arrangements (Action 12); and
- Make dispute resolution mechanisms more effective (Action 14).

December 2015

- Transfer pricing to limit base erosion via interest deductions (Action 4);
- Counter harmful tax practices more effectively (Action 5); and
- Develop a multilateral instrument to modify bilateral tax treaties (Action 15).

GST and cross-border trade in services, intangibles and goods

9. The Digital Economy Task Force (as part of Action 1 under the Action Plan) and the OECD's Working Party 9 on Consumption Taxes are recommending guidelines for determining the place of consumption and, therefore, the right to tax in relation to services and intangibles. This will be accompanied with a recommendation that foreign suppliers register for consumption tax purposes in the country of consumption and pay local value added tax or goods and services tax, primarily in relation to business-to-consumer services and intangibles (at this stage separately from the services and intangibles guidelines). Working Party 9 will also consider the question of the low-value threshold for goods.

10. We are intending to report to you following this month's meeting of Working Party 9, before the planned release of an OECD public consultation document on services and intangibles in December.

New Zealand timeline for deliverables relating to New Zealand domestic law reform

Action Plan items

11. While New Zealand's international tax policy settings are generally robust when viewed from a BEPS perspective, there are areas in which New Zealand is actively considering reform to its domestic rules to line up with the OECD's recommendations under the Action Plan. These areas are:

- Neutralise the effects of hybrid mismatch arrangements (Action 2); and
- Limit base erosion via interest deductions (Action 4), in particular, through the use of related-party and high-priced debt.

12. The OECD has already released recommendations for domestic rules to neutralise the effects of hybrid mismatch arrangements (Action 2) (see paragraph 7 above). However, as with all of the recommendations released under the Action Plan to date, these recommendations have been released in draft. This is because the Action Plan aims to provide comprehensive solutions to BEPS, and the recommendations contained in the work already released may be affected by the remaining work scheduled for delivery in 2015. Under Action 2, there is also a commentary to be developed to explain how the recommended rules will operate in practice, and there are remaining technical issues to consider which may require refinement of the draft recommendations.

13. The OECD's recommendations for domestic rules to limit base erosion via interest deductions (Action 4) are not due for release until September and December 2015.

14. The recommendations under Action 2 and 4 will deliver recommended best-practice domestic rules (unlike some of the recommendations under the Action Plan, which will result in changes to international standards, such as the OECD's Model Tax Convention and its Commentary). This means that New Zealand will need to reform its domestic rules if it wishes to adopt the OECD's recommendations. It would be possible to run ahead of the OECD's timeline for final recommendations under these action items. However, it makes sense to wait for the OECD's final recommendations before consulting on the merits of adopting those recommendations, or other similar rules, in order to:

- Develop proposals that are guided by the final recommendations resulting from the Action Plan;
- Ensure the most efficient and effective consultation process; and
- Have the support of a final international consensus on the optimal design of the rules.

15. We propose to continue work on considering the need for possible reform to domestic rules aimed at neutralising hybrid mismatch arrangements and limiting base erosion via interest deductions through the use of related-party and high-priced debt, with the intention that public consultation documents would be released for each of these areas of work in late 2015 (following the release of the OECD's final recommendations under the Action Plan).

Other BEPS-related work

16. There are other areas of work, although not specific to an action item under the Action Plan, in which New Zealand's current international tax settings could be improved to address BEPS concerns. These areas include:

- Reviewing the taxation of foreign trusts;
- Strengthening non-resident withholding tax ("NRWT") rules; and
- Improving the quality and usefulness of tax information via administrative measures ("BEPS Compliance Measures") to:
    - Require large corporates to file income tax returns earlier so that information can be analysed and issues identified sooner;
    - Require large corporates to disclose additional information that is readily available to them in a standard format so that it can be quickly analysed; and
    - Introduce a voluntary code of practice for large corporates which would likely include having good tax governance, a transparent relationship with Inland Revenue and avoid aggressive tax planning.

17. We intend to report to you regarding a review of the rules for taxing foreign trusts prior to the end of the year.

18. We also intend to report to you on the projects regarding strengthening the NRWT rules and the BEPS Compliance Measures with a view to public consultation documents being ready for release in mid-2015. These documents can be released prior to the finalisation of the OECD's work under the Action Plan, because the recommendations coming out of the Action Plan do not specifically address these matters.

Automatic exchange of information

19. G20 leaders announced the automatic exchange of information ("AEOI") initiative in September 2013 and New Zealand joined in the adoption of a general statement of support for the initiative in May 2014. New Zealand has made a political commitment to begin exchanging information on a voluntary basis from 2018 and on a mandatory basis in 2019. This is in line with Australia's implementation timeline.

20. AEOI will impose a new global standard that will require automatic exchange of information on financial assets based on the United States' Foreign Account Tax Compliance Act ("FATCA") requirements. It will require financial institutions to undertake enhanced due diligence procedures on account holders and then to report ownership and further account

information to their local tax authority, which will be automatically exchanged with applicable EOI treaty partners.

21. We are continuing to work through domestic implications including necessary legislative changes and the costs of systems implementation options.

22. A caveat to New Zealand's political commitment is that it is subject to our ability to enact any necessary legislation by the end of 2016. This timing will ensure that any financial institutions that wish to comply on the voluntary timeline are legally able to commence customer due diligence and reporting to Inland Revenue from the beginning of 2017. We are therefore working towards introducing the required legislation in the bill planned for introduction in November 2015.

23. A second caveat to New Zealand's political commitment is that it is subject to our ability to build the necessary Inland Revenue systems in time. In terms of systems implementation options, Inland Revenue's intent has always been to build on the FATCA implementation solution due to the fact that AEOI is similar to FATCA in many respects, but on a much larger scale. As FATCA has now moved in the direction of third party vendor off-the-shelf software, we are in the process of determining whether this new software is a feasible option for AEOI.

International tax treaty programme

24. In tandem with the work detailed above, we continue to work on updating our international tax treaty network. We expect that, in 2015, we are likely to be involved in negotiations for:

- DTAs/protocols with Korea, Australia, Norway, Slovak Republic, China, Portugal and Samoa.

- A TIEA with San Marino. We will also complete TIEA negotiations that are currently in progress with Antigua and Barbuda, Aruba, Grenada, Macao and Monaco. (Note that The Multilateral Convention on Mutual Administrative Assistance in Tax Matters is now the preeminent exchange-of-information treaty, and as a result, it is unlikely that many further TIEAs will be entered into.)

[Information withheld under section 6(a) of the Official Information Act 1982 to avoid prejudice to New Zealand's international relations.]

Consultation

25. Treasury was consulted and agrees with the contents of this report.

Appendix A

1. Action Plan Items					
BEPS Action Plan Item	**OECD action**	**Date**		**Commencement of corresponding New Zealand reform process**	
Tax challenges of the digital economy (Action 1)	Public consultation document – VAT/GST on cross-border services and intangibles (WP 9)	Dec 2014		To be discussed with the Minister of Revenue	
Neutralise hybrid mismatch arrangements (Action 2)	*Draft recommendations*	*Sept 2014*		Public consultation document	Late 2015
	Commentary	Sept 2015			
	Final recommendations	Dec 2015			
Limit base erosion via interest deductions (Action 4)	Public consultation	Feb 2015		Public consultation document	Late 2015
	Draft recommendations	Sept 2015, Dec 2015 (transfer pricing)			
	Final recommendations	Dec 2015			
2. Other BEPS-related work	OECD action	Date		New Zealand action	Date
Review taxation of foreign trusts	N/A	N/A		Report to Minister of Revenue	December 2014
Strengthen NRWT rules	N/A	N/A		Public consultation document	Mid-2015
Improve quality and usefulness of tax information via administrative measures	N/A	N/A		Public consultation document	Mid-2015
3. Other related areas of work	G20 action	Date		New Zealand action	Date
AEOI	*Common Reporting Standard released*	*Feb 2014*		*Adoption of general statement of support*	*May 2014*
	Commentary to Common Reporting Standard released	*July 2014*		*Political commitment to implementation timeline*	*Oct 2014*
				Introduction of legislation	Nov 2015

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax policy report: BEPS progress update

Date:	19 August 2014	**Priority:**	Medium
Security Level:	In Confidence	**Report No:**	T2014/1412 IR2014/366

Action sought

	Action Sought	**Deadline**
Minister of Finance	**Note** the contents of this report	None
Minister of Revenue	**Note** the contents of this report	None

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
Carmel Peters	Policy Manager	[Telephone numbers withheld under section 9(2)(a) of the Official Information Act 1982 to protect the privacy of natural persons.]
Steve Mack	Principal Advisor, Treasury	
Tom Broadhead	Senior Policy Analyst	

19 August 2014

Minister of Finance
Minister of Revenue

BEPS progress update

Executive summary

The first set of deliverables from the G20/OECD BEPS Action Plan (the Action Plan) will be released mid-September just ahead of the G20 Finance Minister's meeting on the 20th and 21st of September. This report updates you in relation to these developments and the process going forward.

The Action Plan addresses problems of tax minimisation and avoidance that have arisen from out-dated concepts, deliberate tax competition and poorly co-ordinated domestic rules. New Zealand has been contributing to the plan since its release in July 2013 and has also identified domestic reforms which would address weaknesses in our own international rules.

The Action Plan is spread over 2014 and 2015 (refer to Appendix 1 for a summary). This September the OECD will release reports covering the following seven actions:

- Addressing the Tax Challenges of the Digital Economy (Action 1)
- Neutralise the Effects of Hybrid Mismatch Arrangements (Action 2)
- Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance (Action 5)
- Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (Action 6)
- Modifications of Chapters I, II and VI of the OECD Transfer Pricing Guidelines Related to Transfer Pricing Aspects of Intangibles (Action 8)
- Modifications of Chapters V of the OECD Transfer Pricing Guidelines Related to Documentation (Action 13)
- Developing a Multilateral Instrument to Modify Bilateral Tax Treaties (Action 15)

We support the approaches taken in all the reports on the basis that they are generally consistent with the principles of international taxation and administration that we follow. We note, however, that there is considerable work remaining to address outstanding technical and implementation issues. Further briefings on the detail of the papers will be provided to you

ahead of their release in mid-September. Note the remaining Action Plan deliverables are due in September and December 2015.

Of these actions New Zealand has been closely involved in the work on treaty abuse and transfer pricing because new rules will have important implications for the operation of our treaty networks.

In addition, we are giving high priority to those actions that we expect to be important in terms of guiding our future domestic law reform programme such as those concerning hybrid mismatches, certain of the 2015 deliverables relating to interest deductibility and transfer pricing, and GST and online shopping.

For instance, hybrid entities and instruments, which give rise to differing tax treatments in two countries resulting in double deductions or deductions without corresponding income, are a source of BEPS problems in New Zealand. The OECD is developing proto-type domestic law rules which link the domestic tax treatment of an entity or instrument with the tax outcomes in the other jurisdiction. These rules will be important in determining the design of New Zealand domestic tax reforms to counter hybrid mismatch arrangements affecting our tax base.

Similarly, while we have taken some measures to address profit shifting by multinationals taking excessive interest deductions in New Zealand, there are further issues to address. The work being undertaken by the OECD on best practice domestic law measures in relation to thin capitalisation rules and pricing of debt will be important to us in terms of guiding our future work in this area.

In addition to the issues regarding interest deductibility we have a concern regarding the robustness of our own non-resident withholding tax (NRWT) rules in respect of interest. NRWT is an existing profit shifting prevention measure which applies a final layer of tax on interest payments made to other jurisdictions. However, we have identified deficiencies in New Zealand's rules that can lead to the indefinite deferral of NRWT or the avoidance of NRWT entirely.

New Zealand's indirect tax base (GST) can also be considered in the BEPs context, in particular the impact of online shopping. In early 2015 the OECD will publish draft international guidelines for the application of GST/VAT regimes on cross border business-to-consumer transactions.

Finally, we have also been working on a number of administrative measures that aim to improve the quality and usefulness of tax information.

Work is underway to identify the costs and benefits of shortening the length of time large corporates have to file tax returns and introducing a new, standardised electronic disclosure which would replace an existing and inefficient manual process. We have formed a technical reference group of software developers, tax agents and corporate tax managers to ensure that our proposals are robustly tested and widely socialised.

Consideration of the feasibility and usefulness of a code of practice for large corporates continues and includes both government-led and business-led models.

As indicated in previous reports, we would recommend that any domestic reforms would be developed using the generic tax policy process.

Recommended action

We recommend you note the contents of this report.

Steve Mack
Principal Advisor
Tax Strategy
Treasury

Carmel Peters
Policy Manager
Policy and Strategy
Inland Revenue

Hon Bill English
Minister of Finance

Hon Todd McClay
Minister of Revenue

Background

1. In early 2012 the amount of tax being paid by multinational companies was in the spotlight following the global financial crisis, the bailouts in the financial services sector and the introduction of austerity measures in some European countries. In June 2012 the G20 called on the OECD to report on the "the need to prevent base erosion and profit shifting (BEPS)" and the resulting report, published in February 2013, announced the development of a BEPS Action Plan.

2. The 15 point Action Plan was released in July 2013 and proposed an ambitious programme of reforms over 2014 and 2015. In August 2013 officials set out a programme of potential domestic reforms to address weaknesses in New Zealand's international tax rules (refer T2013/2059, PAS2013/152 – *Taxation of multinationals* – herein the August 2013 report). This report was subsequently released to the public in October 2013.

3. In June 2014 the OECD's Committee on Fiscal Affairs (CFA) met to consider the seven 2014 deliverables in the Action Plan (refer IR2014/364 - OECD Committee on Fiscal Affairs meeting). The remaining deliverables in the Action Plan are due in September and December 2015 (refer Appendix 1).

Release of the 2014 OECD BEPS Action Plan papers

4. Seven papers and an accompanying explanatory statement will be publically released in mid-September, ahead of the G20 Finance Minister's 20-21 September 2014 meeting. Until this time the papers are in draft form and the OECD has requested countries refrain from publically commenting on the detail of the recommendations. Officials will prepare briefings for you on the paper closer to the time of release.

5. To date the focus of our domestic law reform efforts has been to develop our thinking through participating in the drafting the OECD's BEPS action reports. It is desirable to propose reforms to New Zealand law that take into account the direction of OECD proposals on related issues. Any recommendations for reform that result from this work should be subject to the normal generic tax policy process.

6. Overall we support the direction that the OECD BEPS work has taken to date. The suggested approaches are consistent with the general principles of international taxation and administration that New Zealand follows. The following sections comment on the papers being released in September, set out the priorities for 2015 and provide an update on the associated New Zealand law reform projects.

Action 1: Address the tax challenges of the digital economy (2014)

7. The September Action 1 paper will recommend against any solution that targets the digital economy specifically as it is increasingly indistinguishable from the wider economy. Some aspects of the digital economy exacerbate BEPS issues and these features will be considered under the relevant BEPS actions.

Online shopping

8. The OECD's work in relation to the online shopping issue has been referred to by the Digital Economy Task Force as part of a wider project relating to the VAT/GST treatment of cross-border supplies of services and intangibles. The project is being undertaken by the consumption taxes working party (Working Party 9) with the objective of producing international guidelines for both business-to-business (B2B) and business-to-consumer (B2C) transactions.

9. The B2B guidelines, by setting out agreed approaches to determining the place of taxation, are intended to ensure that VAT/GST does not become a cost to businesses trading internationally given that VAT/GST is intended to be a tax on consumers, not businesses. The OECD signed off these guidelines earlier this year following public consultation and they were endorsed by a global forum in Tokyo in April. They also served as part of the background to the recent GST changes made in New Zealand to allow foreign businesses to claim back GST paid here.

10. Working Party 9 has now turned its attention to developing the B2C guidelines. It is expected that these will be finalised early next year and follow the same consultation process as the B2B guidelines. It is expected that OECD will provide a paper for public consultation early next year. It is likely that it will also set out rules around the place of supply and suggest that one approach to the collection of GST on intangibles such as digital downloads is for the foreign supplier to register for VAT/GST in the country of consumption. While the guidelines may not specifically address the question of low-value goods, Working Party 9 and the OECD more generally are aware of the relevance of the guidelines to this question.

Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (2014)

11. The September Action 2 paper will recommend co-ordinated domestic law reform and updates to tax treaties which, once implemented, will eliminate hybrid mismatches. This will mean that taxpayers will no longer be able to claim two deductions for the same expense, claim a deduction without a corresponding tax liability, or generate multiple foreign tax credits from a single tax payment. Further implementation guidance in the form of a commentary will be released by September 2015.

12. New Zealand has participated in this work and is comfortable with the overall direction of the OECD proposals.

13. While the main recommendations have been completed, considerable technical work will be needed in 2015 to develop the commentary and address implementation issues.

Implications for domestic reform – hybrid mismatches

14. Our August 2013 report proposed to "explore whether New Zealand should restrict interest deductions on hybrid instruments where the interest payment is not taxed in the foreign jurisdiction" and "explore the need for an anti-arbitrage rule for offshore entities who seek double non-taxation of income or double deductions of expenditure by taking advantage of differences between countries' tax rules." These two lines of enquiry have been considered together by the OECD as hybrid mismatch arrangements.

Issues

15. Action 2 of the Action Plan aims to neutralise the effects of hybrid mismatch arrangements by developing model treaty provisions and recommendations regarding the optimal design of domestic tax rules. Hybrid mismatch arrangements use the different tax treatment of a hybrid entity or instrument between two or more countries to achieve double non-taxation or long term tax deferral, by, for example, creating two deductions for one borrowing (a double deduction (DD) outcome) or creating a deduction without a corresponding income inclusion (a deduction/no inclusion (D/NI) outcome). This is usually achieved as a result of a mismatch of domestic laws, but the application of double tax treaties can be used to enhance the tax benefit (for example, via the elimination or reduction of withholding taxes at source). It is often difficult to determine which of the countries involved has lost tax revenue, but there is a reduction of overall tax paid by the parties as a whole.

16. Notably, Inland Revenue has identified a number of arrangements being used by New Zealand taxpayers that exploit the different tax treatment of entities. One example is the use of an Australian limited partnership ("ALP") between Australia and New Zealand (i.e. a hybrid entity) to achieve a DD outcome.

17. In terms of the taxation of hybrid instruments, officials previously recommended that there be no changes to current domestic settings, but that recommendation pre-dated the release of the Action Plan (refer PAD2012-216/T2012-2356 – *Tax deductions for hybrid instruments issued by New Zealand companies*). In addition, officials signalled that the advice would need revisiting if planned Australian law changes in this area, which could increase the fiscal cost to New Zealand of the use of hybrid instruments, proceeded. The Australian Government has recently released draft legislation indicating that those changes will proceed,[1] although the proposals have not yet passed into law.

OECD Proposals

18. The September Action 2 paper provides:

- a definition of a hybrid mismatch arrangement;
- recommendations for countries seeking to amend their domestic law in order to:

[1] Tax and Superannuation Laws Amendment (2014 Measures no. 4) Bill 2014.

  - prevent mismatches from arising (general domestic rule recommendations) and
  - neutralise their effect (hybrid mismatch rules); and

- a discussion of recommended changes to the OECD Model Tax Convention to deal with hybrid entities, and the interaction between domestic rules and the OECD Model Tax Convention.

19. The bulk of the paper is a discussion of the recommended hybrid mismatch rules. These are *linking rules* that seek to align the tax treatment of an instrument or entity with the tax outcomes in the counterparty jurisdiction, but otherwise do not disturb the tax or commercial outcomes. To ensure that the mismatch is eliminated even when not all the jurisdictions adopt the rules, the recommended rules are divided into a primary response and a defensive rule; the defensive rule applying when there are no hybrid mismatch rules in the other jurisdiction or the rules are not applied to the entity or arrangement. In brief:

- For a D/NI outcome, the primary response should be to deny the deduction in the payer's jurisdiction. If the payer jurisdiction does not respond, the defensive rule would require the payment to be included as ordinary income in the payee's jurisdiction.

- For a DD outcome, the primary response should be to deny the duplicate deduction in the parent jurisdiction. A defensive rule would require the deduction to be denied in the payer jurisdiction only if the parent jurisdiction did not adopt the primary response.

- To deal with an indirect D/NI outcome, a payer jurisdiction should deny a deduction for a payment where the payee sets the payment off against expenditure under a hybrid mismatch arrangement.

Next steps

20. The OECD's recommendations, as set out in the paper, are due to be published in September 2014. A further commentary providing in depth explanations and examples detailing how the domestic rule recommendations will operate in practice, and considering some remaining technical issues, is intended to be published by September 2015. Additional work concerning the application of the rules to hybrid regulatory capital that is issued intra-group, and the interaction of the rules with CFC rules, is intended to be published together with the commentary. We will report to you further on whether these types of rules would be useful to adopt in the New Zealand context to counter BEPS.

Action 4: Limit base erosion via interest deductions and other financial payments (2015)

21. This action is due to report in 2015 and addresses a key risk to New Zealand of multinationals using debt (and other financial payments) to shift profit offshore. New Zealand has been and will continue to be closely involved.

Implications for domestic reform - thin capitalisation

22. The August 2013 report proposed to "examine problems with tax rules (thin capitalisation and transfer pricing) designed to prevent profit shifting by non-residents who fund their New Zealand investment using related party debt." As mentioned earlier, the relevant OECD analysis and proposals on this issue will not be finalised until September 2015 – although draft proposals will be published for consultation earlier.

23. New Zealand has thin capitalisation rules that, by and large, work effectively to limit profit shifting by non-residents through excessive interest deductions. These rules were recently amended to improve their robustness, most notably by extending them so they apply to non-residents who act together when investing into New Zealand. Previously the rules only applied to investments controlled by a single non-resident.

Issues

24. Despite these recent amendments, the rules could benefit from a more fundamental review. A key issue is that, under the current rules, profit stripping can still be achieved by using debt with a very high interest rate.

25. The thin capitalisation rules place limits on the amount of debt that can be put into New Zealand. Transfer pricing rules should limit the interest rate charged on the loan. However, we are concerned that there is still considerable scope for most (or all) of a firm's profits to be shifted out of New Zealand through loading debt up to the thin capitalisation limits and thus artificially weakening the local subsidiary's relative financial position. The increased risk of default can result in more highly priced related party debt producing very high interest deductions despite meeting the requirements of the current thin capitalisation rules.

Other issues being considered by the OECD

26. As well as the issue of high-priced debt, the OECD's work on interest deductions will also consider other design aspects of thin capitalisation rules. This includes whether the allowable level of debt should be based on a company's parent's worldwide debt from external lenders, or if the rules should feature a so-called safe harbour. Safe harbours allow debt up to a certain level (such as 60% of assets) without need to defend the level of gearing by reference to company's parent's overall worldwide debt level. While they reduce compliance costs, it can be argued that they allow room for profit shifting as companies with little or no worldwide debt can nevertheless utilise related-party debt up to the safe harbour.

27. We will consider whether there is cause to review other aspects of our domestic thin capitalisation rules, such as the use of safe harbours, in light of the findings of the OECD.

Next steps

28. We will continue to analyse the potential issues above (especially in light of our involvement with the on-going work at the OECD). This will include investigating the data available to help quantify the extent of each problem.

Implications for domestic reform - non-resident withholding tax (NRWT)

29. The August 2013 report proposed to "address problems with the application of non-resident withholding tax to related party debt". While the OECD is not looking at NRWT issues specifically we consider this work to be consistent with BEPS as it aligns with the general concern regarding tax reductions from international tax planning.

30. NRWT is deducted from interest that is paid from a New Zealand resident to an associated non-resident. NRWT acts as a safeguard against multinationals stripping profit from New Zealand through interest by imposing a final layer of tax on the payments. Cross-border interest payments between non-associated parties may be subject to approved issuer levy (AIL) which replaces the NRWT rate of generally 15% with a 2% levy charged to the borrower. AIL was introduced to lower the cost of capital for New Zealand borrowers and recognises that the issue of profit stripping between non-associated parties generally does not arise.

Issues

31. We have identified areas where the NRWT regime does not appear to be working as intended including that:

- the rules that trigger when NRWT is deducted are deficient;
- the associated person test for NRWT may not be sufficient; and
- payments made to non-residents operating a New Zealand branch are not subject to the rules.

When NRWT is deducted

32. New Zealand's rules for taxing debt (the "financial arrangement" rules) aim to match the income and expenditure of the lender and borrower by spreading the amounts across the term of the agreement regardless of when the payments are actually made or received. The general result is that a deduction for accrued interest is claimed by the borrower when the amount is taxable to the lender.

33. In a purely domestic setting these rules work well as both sides file returns and have their tax assessed. In a cross-border transaction where a New Zealand borrower pays interest to a non-resident lender the NRWT is withheld from the interest by the borrower and returned to Inland Revenue on the non-resident's behalf.

34. The problem that arises is that NRWT only applies to interest when it is actually **paid.** Accordingly**,** a deduction may be available to a New Zealand borrower under the financial arrangement rules for interest without a corresponding obligation to withhold NRWT. In some cases it may be possible to create debt instruments where the terms are such that there is an indefinite deferral of the obligation to pay NRWT.

35. Another issue is that, for the purposes of NRWT, interest generally means a payment for money lent. Money lent includes an amount of money lent to a person (e.g. a standard loan) and an amount of credit given to a person (e.g. a deferral of an amount to be paid). We have encountered cases where payments that are economically equivalent to interest are not captured by these definitions.

Who is subject to NRWT

36. AIL is paid by the borrower at 2% and eliminates the NRWT obligation but only in cases where the parties to the transaction are not associated. We have concerns that this requirement for non-association can be circumvented

37. One concern relates to associated parties inserting an unrelated intermediary in a back-to-back loan arrangements in order to qualify for AIL when the loan when otherwise be between those associated parties and therefore subject to NRWT.

38. Another concern is the situation where the loan is made by a group of unrelated non-residents that, taken as a group, own a controlling stake in the New Zealand entity. If these non-residents are acting together they can shift profit from the New Zealand entity through interest deductions but pay AIL rather than NRWT as they are not considered associated with the New Zealand entity. This issue is similar to the problem recently addressed through changes to the thin capitalisation rules (refer PAS2013/181 - *Thin capitalisation review: final decisions*).

NRWT and onshore branches

39. NRWT does not apply to any interest payments made to a non-resident that operates a branch in New Zealand. This means the withholding obligations for a New Zealand person borrowing from a New Zealand branch of a foreign bank are the same as if they borrowed from a New Zealand resident bank. This exemption applies because in many cases the interest will be subject to New Zealand tax as part of the branch's income.

40. However, the exemption from NRWT applies even when the lending has no connection with the New Zealand branch. This means the exemption can be used by non-resident companies to lend to their New Zealand subsidiaries without needing to pay NRWT or treat the interest as income of the New Zealand branch (provided the parent company operates a branch in New Zealand). This is inappropriate. As the lending is from an associated non-resident, the resulting interest payments should attract NRWT.

Next steps

41. This work is being considered in conjunction with the proposals being developed as part of BEPS action 4 (limit base erosion via interest deductions and other financial payments). We will continue to analyse the issues identified and will report to you again with proposed solutions and a consultation plan.

Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance (2014)

42. The September Action 5 paper will include a review of OECD member countries and identifies which countries have preferential tax regimes. A common feature of such regimes, particularly those relating to intellectual property, is that they allow a taxpayer to benefit from the regime with little, if any, economic activity occurring in the jurisdiction. The report recommends that taxpayers should be required to have "substantial activity" in the jurisdiction

before benefitting from a preferential regime and provides guidance on how this criteria might be assessed.

43. We have monitored this work and we are comfortable with the direction taken.

Action 6: Prevent treaty abuse (2014)

44. The September Action 6 paper will make a number of recommendations on countering general and specific forms of treaty abuse. These include:

- Tax treaties should clearly state that the treaty is intended to prevent double taxation *and* double non-taxation or tax minimization through evasion or avoidance.
- Tax treaties should include a rule that restricts the types of taxpayers that can access treaty benefits (commonly known as a limitation on benefits or LOB rule).
- Tax treaties should include some form of general anti-abuse rule requiring that transactions do not have tax benefits as a principal purpose.

45. New Zealand is comfortable with the direction this work has taken.

46. In 2015 the focus will shift to drafting the specific changes to the OECD Model Tax Convention, and consideration of how changes to existing treaties could be expedited through the multilateral instrument.

Action 7: Preventing the artificial avoidance of permanent establishment status (2015)

47. This action is due to report in 2015. The concept of a "permanent establishment" is a key component of the OECD Model Tax Convention. It sets the threshold for determining whether a non-resident has established enough of a presence in a jurisdiction to warrant being taxable in that jurisdiction. The meaning largely revolves around determining whether the non-resident has a fixed place of business in that jurisdiction.

48. Action 7 is focussed on the question of whether the definition of a "permanent establishment" is out-of-date or can be easily avoided. Any recommendations made in this report will involve changes to the Model Tax Convention and related commentaries.

49. New Zealand is participating in this work because it may have important implications for the future of our treaty network. As a net capital importer we are in favour of a permanent establishment rule that sets a reasonable boundary for establishing a taxing right in New Zealand. As things stand we favour a slightly broader concept of permanent establishment in our treaties than that contained in the OECD Model Tax Convention.

50. On the other hand, we recognise the need to strike the right balance. That is, to ensure that the concept of permanent establishment does not get so broad that non-residents with a

very limited presence in a jurisdiction get caught up in that jurisdiction's tax system – with all the resulting compliance costs.

Actions 8, 9 and 10: Assure that transfer pricing outcomes are in line with value creation –intangibles, risk and capital, other high risk transactions (2014 and 2015)

51. The September Action 8 paper will make some progress on amending the transfer pricing guidelines to better assist taxpayers and revenue authorities dealing with intangible property transactions. This work is intrinsically linked to the 2015 deliverables relating to risk, capital and financial transactions and the full guidance on intangibles will not be delivered until September 2015.

52. New Zealand has been contributing to this work and we are pleased with the decision to defer some parts of the review so that it can be considered holistically along with related proposals.

53. The remaining work under the three actions points looks at some of the most complex and fundamental issues in base erosion and profit shifting – potential solutions may have far reaching implications for New Zealand. The OECD are planning to have five or six Working Party 6 meetings in 2015 and officials are considering at how they most effectively contribute to this work.

Action 13: Modifications of Chapters V of the OECD Transfer Pricing Guidelines Related to Documentation (2014)

54. The September Action 13 paper will recommend a three tiered approach to documentation, including:

- a master file which outlines the multinational's global structure, strategies and business model;
- a country-by-country report which provides an overview of where employees, assets and activity is located and where taxes are paid and accrued; and
- a local file which provides detailed information relevant to that jurisdiction.

55. The intention is that the master file and country-by-country report should be available to all jurisdictions where the multinational is present.

56. New Zealand supports the approach taken which balances the needs of revenue authorities, who want more information, with the needs to the private sector, who want to minimise compliance costs.

57. Some implementation issues still need to be resolved in 2015. Key amongst those issues is whether multinationals will file their master file and country by country report once

in the ultimate parent entity's jurisdiction or whether they will need to separately file the documents in all of the jurisdictions where they have a presence. If the former option is adopted then the information could be shared through treaty networks, however this would exclude many developing nations who do not have extensive treaty networks. However the latter option raises commercial confidentiality concerns as some nations lack the legal safeguards of tax secrecy or privacy legislation.

Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties (2014)

58. The September Action 15 paper will conclude that a multilateral instrument should be developed to at least incorporate changes to tax treaties.

59. New Zealand has not been closely involved in this work. We are pleased to see that a multilateral instrument is feasible as the alternative, renegotiating all treaties to incorporate BEPS proposals, would not be practical.

Other BEPS actions

60. The remaining four actions not covered above relate to controlled foreign companies (Action 3), statistical and economic analysis of BEPS (Action 11), disclosure of aggressive tax positions (Action 12) and disputes resolution (Action 14). Officials continue to follow developments in these projects.

Domestic administrative proposals

61. In addition to international and domestic policy reform, officials have been developing a number of administratively focused proposals which aim to improve transparency between Inland Revenue and large corporates.

Targeted electronic disclosures

62. The August 2013 paper proposed to explore "improving information disclosure for large companies."

63. Under current practice, large corporates file a Basic Compliance Package (BCP) when they submit their income tax return. The BCP includes the taxpayer's financial statements, group structure and tax reconciliation.

64. There is no prescribed format for this information – generally it is received as PDFs of the relevant documents in as many different formats as there are taxpayers. Investigators then

manually go through the documents in order to identify the key points of data needed to perform a risk assessment.

65. In a separate project Inland Revenue is developing an automated risk assessment tool which will be able to take key points of data from a standardised electronic form and quickly apply a range of tests and criteria to identify areas of concern. We are proposing to replace the existing manual BCP with a new disclosure which would be standardised, electronic and feed directly into Inland Revenue's new automated risk assessment tool.

66. This will offer benefits both to Inland Revenue, through eliminating costly manual work and freeing up investigators to work on audits, and taxpayers, through faster risk assessments. Currently Inland Revenue takes between three to six months from receipt of a BCP to advise a taxpayer whether further information is needed or further action is being taken. We aim to reduce this to one to two months, providing earlier practical certainty to large corporates.

Technical reference group

67. The accounting systems and software packages supporting large corporates and their tax agents are complex and often highly customised. Developers and tax managers need adequate lead in time to implement changes and particular care needs to be given when selecting what information should be disclosed.

68. In order to get early and expert advice in the lead up to preparing an issues paper we have recently formed a reference group including representatives from CAANZ, large corporates and the specialist software developers that provide products and services to them. It is our intention to work closely with this group so that the final product will extract the best information at the lowest compliance cost.

Next steps

69. Officials intend to report on the costs and benefits of this proposal in November 2014 and will seek approval to consult with the wider public.

Earlier returns

70. Tax returns are due four months after the end of the taxpayer's income year (7 July for a standard 31 March balance date) unless covered by an extension of time. Large corporate taxpayers are almost entirely covered by the extension of time offered to all clients of tax agents – they are able to file their returns by the end of the next tax year.

> *Example – ABC Co is a subsidiary of a US company and has a 1 January to 31 December income year to align with the standard US financial year. They have an "early" balance date as their income year ends before the 31st of March. Their 2013 income year runs from 1/1/2012 to 31/12/2012. Their 2013 tax return is due on 31/03/2014 as this is the end of the next tax year (the tax year always runs from 1 April to 31 March). This gives the taxpayer 15 months from the end of their income year to file their tax return.*

71. This extension means that Inland Revenue may not receive an income tax return for up to 18 months after the end of the taxpayer's income year. Detecting, preventing and addressing tax avoidance is made more difficult when the information analysed is delayed. This applies both in the operational (audits and investigations) and policy (trend identification) arenas.

72. New Zealand is out of step with the international norms for return filing due dates which are generally around six months from the end of the income year. This does not align with Inland Revenue's strategic direction of being an intelligence-led, world class tax administration.

73. This proposal would see large corporates file their returns within six months of the end of their income year.

Next steps

74. The technical reference group formed to support the targeted electronic disclosures proposal will also inform this work. Officials intend to report on the costs and benefits of this proposal in November 2014 and will seek approval to consult with the wider public.

A code of practice for large corporates

75. The August report proposed to "consider introducing a code of practice for large corporates" and look specifically at the UK Code of Practice on Taxation for Banks (the UK code). In addition to the UK code we are also considering a business-led code of practice, in particular the statement produced by the Business and Industry Advisory Committee (BIAC), an independent international business association devoted to advising government policymakers at the OECD. We have had some informal conversations with stakeholders on what role such a code might have in New Zealand.

Next steps

76. Officials will continue to evaluate the strengths and weakness of a code of practice, both government-led and business-led, and will report to you with recommendations later in the year.

Other items

77. The August 2013 paper referred to a number of proposals that have either been formally deferred or have yet to be progressed. This section outlines the status of each proposal:

- *Examine incoherence relating to different tax treatment of "look through vehicles" and structures.* This issue is being considered as part of the review of tax rules for closely-held companies.

- *Design the active income exemption for offshore branches to ensure it does not facilitate profit shifting through repatriation of losses.* This proposal has been deferred in the latest work programme report (refer IR2014/363, T2014/1188 *Tax policy work programme update – July 2014*).
- *Review the tax treatment of foreign trusts.* Officials plan to progress this work in 2015.
- *Aligning AIL information disclosure with NRWT disclosure requirements*. This proposal has been deferred in the latest work programme pending further work on the OECD automatic exchange of information project.

Appendix 1 – Summary of BEPS actions

Action	Deliverables	NZ approach
1 – Address the tax challenges of the digital economy	Report identifying issues raised by the digital economy and possible actions to address them by September 2014	Comfortable with the outcomes of this work. Closely involved with the on-going work on GST/VAT issues.
2 – Neutralise the effects of hybrid mismatch arrangements	Changes to the OECD Model Tax Convention and recommendations regarding the design of domestic rules – September 2014	Closely involved – recommendations will inform any domestic law reform.
3 – Strengthen CFC rules	Recommendations regarding the design of domestic rules – September 2015	Watching brief. NZ CFC rules are already robust.
4 – Limit base erosion via interest deductions and other financial payments	Recommendations regarding the design of domestic rules – September 2015; changes to the OECD Transfer Pricing Guidelines – December 2015	Closely involved – recommendations will inform any domestic law reform.
5 – Counter harmful tax practices more effectively, taking into account transparency and substance	Finalise review of member country regimes – September 2014; Strategy to expand participation to non-OECD members – September 2015; revision of existing criteria – December 2015	Watching brief. NZ does not have tax practices considered harmful by the OECD.
6 – Prevent treaty abuse	Changes to the OECD Model Tax Convention and recommendations regarding the design of domestic rules – September 2014	Closely involved – NZ chairs the Treaty Abuse focus group and changes to the OECD Model Tax Convention may impact NZ.
7 – Prevent the artificial avoidance of PE status	Changes to the OECD Model Tax Convention – September 2015	Member of the focus group, will continue to be involved.
8 – Assure that transfer pricing outcomes are in line with value creation: intangibles	Initial changes to the OECD Transfer Pricing Guidelines – September 2014; remaining changes to the OECD Transfer Pricing Guidelines and possibly to the OECD Model Tax Convention – September 2015	Closely involved – changes to the guidelines may impact NZ.

Action	Deliverables	NZ approach
9 – Assure that transfer pricing outcomes are in line with value creation: risks and capital	Changes to the OECD Transfer Pricing Guidelines and possibly to the OECD Model Tax Convention – September 2015	Closely involved – changes to the guidelines may impact NZ.
10 – Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions	Changes to the OECD Transfer Pricing Guidelines and possibly to the OECD Model Tax Convention – September 2015	Closely involved – changes to the guidelines may impact NZ.
11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it	Recommendations regarding data to be collected and methodologies to analyse them – September 2015	Watching brief.
12 – Require taxpayers to disclose their aggressive tax planning arrangements	Recommendations regarding the design of domestic rules – September 2015	Watching brief.
13 – Re-examine transfer pricing documentation	Changes to OECD Transfer Pricing Guidelines and recommendations regarding the design of domestic rules – September 2014	Comfortable with the outcomes of this work, watching brief on the further work on implementation.
14 – Make dispute resolution mechanisms more effective	Changes to the OECD Model Tax Convention – September 2015	Watching brief.
15 – Develop a multilateral instrument	Report identifying relevant public international law and tax issues – September 2014; develop a multilateral instrument – December 2015	Watching brief.