

SUBMISSIONS

New Zealand's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

Submissions received for the officials' issues paper *New Zealand's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (March 2017).

Number	Submitter
001	Chartered Accountants Australia and New Zealand
002	PricewaterhouseCoopers
003	KPMG
004	Corporate Taxpayers Group
005	Ernst & Young Limited

New Zealand's implementation of the multilateral convention to implement tax treaty related measures to prevent BEPS

7 April 2017

Chartered Accountants Australia and New Zealand

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7 April 2017

New Zealand's implementation of the Multilateral Convention to Implement Tax Treaties Related Measures to Prevent BEPS
c/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

Dear Cath

New Zealand's implementation of the multilateral convention

We welcome the opportunity to submit our comments on the proposals for New Zealand's adoption of the Multilateral Convention (MLC).

CA ANZ supports the Government's adoption of the MLC. In principle we support the underlying aim of the MLC to counter tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no tax jurisdictions where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLC provides the easiest method of implementing the tax treaty related proposals resulting from the G20/OECD project on base erosion and profit shifting (BEPS) by amending the double tax agreements (DTAs) of the participating jurisdictions within a reasonable time.

However, we are concerned that the effects of the MLC will be far reaching and will apply to all taxpayers with cross-border activities and not just to those large multinational organisations whose arrangements triggered the BEPS project. It will also affect commercial transactions that have been structured in a particular way for commercial non-tax driven reasons.

Given the innovative nature of the MLC we also have concerns that significant unexpected issues will arise that will affect taxpayers. It will be critical that Inland Revenue provides adequate resources to New Zealand taxpayers when other jurisdictions try to tax income New Zealand has already taxed.

We support the proposals for New Zealand to adopt the following MLC provisions:

1. Article 5 – Relief of double taxation;
2. Article 6 – Preventing the granting of treaty benefits in inappropriate circumstances
3. Article 7 – Treaty anti-abuse rules
4. Article 8 – Dividend transfer transactions
5. Article 9 – Land rich company rules
6. Article 10 – Third State PE Rules
7. Article 11 – Application of tax agreements to restrict a party's right to tax its own residents
8. Article 11 – Right to tax own residents
9. Article 12 – Commissionaire arrangements and similar strategies
10. Article 13 – preparatory and auxiliary qualification

Our concerns with the proposals for Articles 3, 4, 14 and 18-26 and consolidated versions of the modified treaties are set out in the Appendix.

If you have questions about our submission please contact us.

Yours sincerely,



Teri Welham
Senior Tax Advocate

Professor Craig Elliffe
Tax Advisory Group

Appendix

Article 3 Transparent Entities

Article 3 is consistent with New Zealand's preferred treaty practice of including provisions in its bilateral treaties to ensure that treaty benefits are available for income derived by or through FTEs.

New Zealand intends to adopt Article 3 of the MLC across all of its covered tax agreements.

Submission

The effect of Article 3 on Collective Investment Vehicles (CIVs) in New Zealand with non-resident beneficiaries needs to be considered.

As a minimum, the treatment of CIVs should be addressed in Inland Revenue guidance.

Comment

The proposed amendments to Article 3, as currently drafted, may lead to a number of unintended adverse outcomes from a taxation perspective for investors who are presently investing through a CIV in a third State (i.e. a State that is neither the investment destination, nor the country of residence for the investor).

Article 4 – Dual resident entities

New Zealand's treaty practice has varied (with most of New Zealand's bilateral treaties prescribing the POEM as the determinative test) but has not previously permitted the competent authorities to decide on the extent of treaty benefits to be granted if the competent authorities are unable to agree on a single jurisdiction of residence.

Submission

New Zealand should consider not adopting Article 4.

Comment

In our view adopting the expanded criteria for determining a dual resident entity's treaty and requiring the competent authorities to attempt to agree on a single jurisdiction of residence will not improve the integrity of the current tie breaker rules nor provide any certainty of outcomes to taxpayers.

Our concerns arise because New Zealand has one of the widest corporate tax residency tests in the world. Consequently, there are a large number of New Zealand dual resident companies. A simple example is when a New Zealand company moves its CEO to Australia and, as a result, the company becomes a dual resident. We consider the expanded criteria requiring the competent authorities to agree on a single jurisdiction will result in significant costs and lengthy delays. It is difficult to see how the competent authorities will agree between place of incorporation and place of effective management

By way of illustration, consider the New Zealand/United States treaty tiebreaker test, which is consistent with proposed Article 4. We understand the question of dual residence has never been settled by mutual agreement between the United States and New Zealand tax authorities. The United States has always refused to resolve the issue.

Further support for not adopting Article 4 is that there is no evidence of problems arising with our current self-assessment regime, which appears to be working well.

Article 14 – Splitting up of contracts

Article 14 is consistent with New Zealand's preferred treaty practice of circumventing deemed PE time thresholds.

New Zealand intends to adopt Article 14 (and possibly enter the reservation permitted by Article 14(3)(b) to exclude bilateral treaties that deem a PE to exist in relation to exploration for or exploitation of natural resources) across its covered tax agreements.

Submission

The issues need to be given further consideration.

Comment

In our view, Article 14 will disadvantage a number of taxpayers for whom splitting of contracts occurs for genuine commercial reasons and is not abusive. To illustrate, a multi-national has subsidiaries in different jurisdictions, with one subsidiary carrying on an engineering consultancy business and another subsidiary carrying on a construction business. Each subsidiary tenders for different parts of the same infrastructure project. Use of the general domestic anti-avoidance provisions or the rule provided in Article 6 of the MLC should be adequate to deal with aggressive avoidance situations.

Articles 18-26 – Arbitration

Part VI is consistent with New Zealand's commitment to implement binding MAP arbitration in its bilateral tax treaties.

New Zealand intends to adopt Article 23(1) – “final offer” or “last best offer” – but accept independent arbitration. It will also require undertakings of confidentiality and reserve the right not to include arbitration provisions in a CTA with jurisdictions that do not require the same (23(6) and (7)).

Submission

New Zealand should not choose to include a DTA as a CTA where the other country chooses not to include the arbitration provisions.

Comment

New Zealand's approach to adopt “final offer” or “last best offer” arbitration but to accept “independent opinion” arbitration if the other party to the CTA chooses this (by entering a reservation) is consistent with New Zealand's model treaty provision. We therefore support adopting Article 23(1). However, we are concerned about New Zealand choosing to include a DTA as a CTA where the other country chooses not to include the arbitration provisions. The extensive changes to international tax rules resulting from the BEPS projects will create divergent interpretations which are likely to create uncertainty and potential conflicts. Without an arbitration process there will be no effective determination. The arbitration process is a means of reducing the risk of conflicting decisions and uncertainty. That is, we are concerned with a situation where an overseas jurisdiction, under a CTA, applies the BEPs provisions in an aggressive way against New Zealand-based tax payers in an overseas jurisdiction. This will leave our taxpayers exposed, with ineffective methods of arbitration not agreed.

GAAR

Submission

Further consideration should be given to entering a free form reservation in respect to arbitration to carve out cases that involve the application of s BG 1 of the Income Tax Act.

Comment

It is not clear that New Zealand's intention to enter a free form reservation in respect of arbitration to carve out cases that involve the application of New Zealand's general anti-

avoidance rule in s BG 1 Income Tax Act 2007 is appropriate. By reserving against these provisions New Zealand effectively prevents mandatory arbitration from being used where the treaty is being abused. In our view mandatory arbitration is essential. It allows the other party to the CTA to agree the treaty is being abused.

Confidentiality

Submission

Further consideration should be given to the proposal to require undertakings of confidentiality of the arbitration proceedings.

Comment

New Zealand's proposal to require undertakings of confidentiality may lead to unintended consequences. For example, not all listed companies may be able to participate in confidential arbitration because they have continuous disclosure obligations to notify the Stock Exchange of any change in the tax status of the company.

Consolidated versions of modified treaties

Submission

The Government should publish and maintain consolidated versions of modified treaties.

Comment

Paragraph 4.18 of the Discussion Document states that the Government will not be producing consolidated versions of each DTA modified by the MLC. This is consistent with existing practice for amending protocols.

Although this is consistent with the current practices for treaties, overlaying MLC amendments will introduce added complexity which we believe justifies a different approach. We consider it is inappropriate for Government to abdicate responsibility for communicating the effects of the MLC.

In our view, the applicable MLC amendments should be consolidated with the existing bi-lateral treaties and maintained on the New Zealand legislation website.

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AUSTRALIA + NEW ZEALAND

Substantive BEPS provisions in the multilateral instrument

BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
1. Neutralising the effects of hybrid mismatch arrangements that have a treaty aspect (Action 2 report)	<p>Fiscally transparent entities</p> <p>The MLI introduces or amends a fiscally transparent entity (FTE) provision. FTEs (like trusts or partnerships) create arbitrage opportunities because they are treated differently for tax purposes by different countries. The MLI provision clarifies that treaty benefits will only be allowed to the extent to which the item of income is taxed in the state in which the entity is resident. New Zealand already includes this provision (or an equivalent provision) in its DTAs with Australia, United States, Chile and Japan.</p> <p><i>Article 3 of the MLI</i></p> <p>Dual resident entities</p> <p>The MLI introduces or amends a dual resident entity (DRE) tie breaker provision. Like FTEs, DREs can be used to take advantage of arbitrage opportunities. The proposed provision will require CAs to agree the residence status of a DRE and the DRE will only be entitled to such treaty benefits as the CAs agree.</p> <p><i>Article 4 of the MLI</i></p> <p>Relief of double taxation</p> <p>The MLI allows countries to strengthen their application of the exemption method to relieve double taxation. New Zealand already applies the (more robust) credit method in all of its DTAs, and therefore proposes not to adopt any of the options.</p> <p><i>Article 5 of the MLI</i></p>	No	Yes	See our submission
2. Preventing the granting of treaty benefits in inappropriate circumstances (Action 6 report)	<p>Preamble language – minimum standard</p> <p>The MLI will amend the preamble to DTAs to emphasise that as well as aiming to relieve double taxation, the treaty also aims to prevent opportunities for non-taxation, reduced taxation or tax avoidance.</p> <p><i>Article 6(1) and (2) of the MLI</i></p> <p>Preamble language – optional amendment</p> <p>The MLI allows countries to adopt the following optional amendment to the preamble to DTAs:</p> <p>“Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,”</p>	Yes	Yes	Yes



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BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
	<i>Article 6(3) and (6) of the MLI</i>			
	Treaty anti-abuse rules		Yes	Yes
	The MLI requires jurisdictions to introduce an anti-abuse rule into DTAs. Jurisdictions can meet this minimum requirement in one of three ways:			Yes
	1. a principal purpose test (PPT) alone; 2. a PPT plus a “simplified limitation on benefits” (LOB) clause. The LOB is a mechanical provision that seeks to identify, through a series of black-letter tests, whether a person is genuinely entitled to the benefits of a DTA; or 3. enter into bilateral negotiations to include a detailed LOB provision plus a PPT or anti-conduit rules.			
	In the case of New Zealand, officials’ favour adopting a PPT alone. The PPT is very similar to New Zealand’s domestic law GAAR and will deny treaty benefits if the principal purpose of an arrangement was to secure those benefits. Also, in officials’ view, it generally covers the same treaty shopping issues as the alternative approaches.			
	<i>Article 7 of the MLI</i>			
	Dividend transfer transactions	No	Yes	Yes
	The MLI introduces a provision that requires shares to be held for a minimum of 365 days for the shareholder to be entitled to the reduced withholding tax (WHT) rates on dividends. This is to stop shareholders buying shares temporarily to access the reduced WHT rates and then immediately selling them.			
	<i>Article 8 of the MLI</i>			
	Land rich company rules	No	Yes	Yes
	The MLI introduces a treaty provision that strengthens the anti-abuse “land-rich company” test (land rich companies are companies whose assets are mainly land). Some treaties do not contain this provision at all, so the MLI also allows it to be inserted into those treaties.			
	The new rule reinforces the position that the source jurisdiction can tax land held by non-resident owners in the other jurisdiction through corporate vehicles. To prevent artificial and temporary dilution of the amount of land held by a company just before sale, the MLI provision requires the threshold for the amount of land ownership which triggers the rule to be measured on every day in the 365 day period leading up to the sale of the shares.			



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BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
	<p>The MLI provision also ensures the same rule applies to other investment vehicles such as partnerships and trusts.</p> <p><i>Article 9 of the MLI</i></p>			
	<p>Third-state PE rules</p> <p>The MLI introduces a treaty provision that denies treaty benefits in the case of income derived by a PE of a resident of one of the parties to the DTA, where that PE is situated in a low tax third-state.</p> <p><i>Article 10 of the MLI</i></p>	No	Yes	Yes
	<p>Right to tax own residents</p> <p>The MLI introduces a provision that preserves a jurisdiction's right to tax its own residents (for example, this prevents New Zealand residents engaged in a tax avoidance arrangement claiming a DTA prevents New Zealand from using the domestic law GAAR to impose tax).</p> <p><i>Article 11 of the MLI</i></p>	No	Yes	Yes
3. Preventing the artificial avoidance of PE status	<p>Commissionaire arrangements and similar strategies</p> <p>Currently, a number of artificial structures including the civil law concept of a "commissionaire" can be used to avoid having a PE in a jurisdiction. A new provision will deem non-residents using these structures to have a PE in the jurisdiction.</p> <p><i>Articles 12 and 15 of the MLI</i></p> <p>Specific activity exemptions – preparatory and auxiliary qualification</p> <p>Certain specific activities carried on in a jurisdiction are deemed not to constitute a PE (for example, premises used for simply storing goods or stock maintained for display or delivery). These specific carve-outs from the PE definition allowed quite substantial economic activities to fall within them. The MLI proposes clarifying that the specific carve-outs listed in the DTA must be subject to an additional requirement that they be "preparatory and auxiliary" in nature. There are two options for dealing with this issues – Option A (which New Zealand favours) which subjects all of the existing specific activities to an explicit "preparatory and auxiliary" test, and Option B, which does not subject the specific activities to the "preparatory and auxiliary" test (because these activities are considered to be inherently</p>	No	Yes	Yes



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BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
	preparatory and auxiliary in nature), but subjects any other activity or combination of activities to the “preparatory and auxiliary” test. <i>Articles 13 and 15 of the MLI</i> Specific activity exemptions – Anti-fragmentation rule The MLI introduces an “anti-fragmentation” rule that will prevent an enterprise from dividing up all of its activities so that related parties each carry on a separate part of the business (that fall within the PE exceptions), but taken together they constitute a PE. <i>Articles 13 and 15 of the MLI</i>	No	Yes	See our submission
	Anti-contract splitting rule Currently a construction, installation or building project does not constitute a PE unless it last for more 12 months. Entities were abusing this 12 month limit by having back-to-back 12 month contracts so they never exceeded the 12 month threshold. Generally the contracts were undertaken by different companies within the same group of companies. The new an “anti-contract splitting” rule will aggregate related projects to prevent PE avoidance. <i>Articles 14 and 15 of the MLI</i>	No	Yes	See our submission
4. Providing improved mechanisms for effective dispute resolution	MAP – access to the CAs of either jurisdiction In covered tax agreements that do not already have it, the MLI will introduce a provision allowing taxpayers to request mutual agreement procedure (MAP) in cases where they believe taxation is not in accordance with the treaty. If a MAP provision is already contained in a DTA, the MLI will amend it to allow taxpayers to approach the CA of <i>either</i> jurisdiction to resolve uncertainty as to how the DTA applies (New Zealand’s DTAs currently contain MAP provisions, but taxpayers are only entitled to approach the CA of the jurisdiction of which they are a resident). <i>Article 16 of the MLI</i>	Yes	Yes	See our submission
	MAP – corresponding adjustment Requires contracting states to make appropriate corresponding adjustments in transfer pricing cases. <i>Article 17 of the MLI</i>	No	Yes	



CHARTERED ACCOUNTANTS
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BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
Arbitration	<p>If, under the MAP process, the CAs do not agree on the correct interpretation of the DTA, the CAs can submit the matter to an independent arbitrator (or a panel of three arbitrators) for decision. The arbitrators will decide which of the CAs is correct. The CAs are generally bound by the decision of the arbitrators, but the taxpayer is not. Therefore, the taxpayer could pursue a court case if it disagrees with the arbitrators' decision.</p> <p>New Zealand's approach is to adopt what is referred to as "final offer" or "last best offer" arbitration (in Article 23(1)), but to accept "independent opinion" arbitration if the other party to the Covered Tax Agreement chooses this (by entering a reservation under Article 23(2)). In the case of "independent opinion" arbitration, New Zealand will adopt Article 24(2) and (3) which means that the arbitrators' decision will not be binding on the CAs if they come to an alternative resolution of all unresolved issues within 3 calendar months of the delivery of the arbitrators' decision.</p> <p>New Zealand also proposes to require undertakings of confidentiality by all parties involved in arbitration (Article 23(5)) and reserves the right not to include arbitration provisions in Covered Tax Agreements with jurisdictions that do not require the same (Article 23(6) and (7)).</p> <p>New Zealand intends to enter a free form reservation in respect to arbitration to carve out cases that involve the application of New Zealand's general anti-avoidance rule contained in section BG 1 of the Income Tax Act 2007.</p> <p><i>Articles 18 – 26 of the MLI</i></p>	No	Yes	See our submission



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(sent via email: policy.webmaster@ird.govt.nz)

7 April 2017

New Zealand's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI)

Dear Madam

Thank you for the opportunity to comment on the Discussion Document (DD). We appreciate that participating in OECD and G20 initiatives to target base erosion and profit shifting globally is a key focus for the government.

We have set out below a number of comments that we would like Officials to consider in relation to the implementation of the MLI.

Notification of entry into effect for specific Covered Tax Agreements should be made earlier (DD Para 4.14)

We appreciate the Government's proposal to publicly announce when the MLI comes into force for each of New Zealand's DTAs. To assist with certainty and to give taxpayers the maximum opportunity possible to prepare for the modification of a DTA, it would be helpful if the Government could also publicly announce:

- the list of DTAs it wishes to modify as notified to the OECD Depository upon signing of the MLI;
- any DTAs it later adds as Covered Tax Agreements; and
- when a jurisdiction which is a party to a Covered Tax Agreement has submitted its instrument of ratification to the OECD Depository (upon notification being received from the OECD Depository) and expected date that the MLI will come into force for that DTA.

Domestic law time limit for tax refunds should be extended (DD Para 4.17)

A taxpayer should be able to claim a tax refund from Inland Revenue if that is the outcome of a Mutual Agreement Procedure (MAP) and Mandatory Binding Arbitration. Given the length of time these proceedings can take, the ability to claim the refund should not be restricted to the 4-year period currently provided for in section RM 2 of the Income Tax Act 2007. Section 78B of the Tax Administration Act 1994 could be amended to allow for an extension of time to claim a refund.

Any matter which is subject to MAP should be able to be subject to Mandatory Binding Arbitration (DD Appendix Para 4)

The policy aim with respect to the proposed reservation to Article 18 of the MLI for section BG 1 of the Income Tax Act 2007 is not clear. The purpose of the new arbitration mechanism is to improve the MAP dispute resolution process – in our view, any matter which is subject to the MAP should also be able to be subject to Mandatory Binding Arbitration because it will assist taxpayers to achieve a more timely resolution of disputes. Perhaps it would be more appropriate for section BG 1 to be reserved from the MAP (and as a consequence not able to be subject to Mandatory Binding Arbitration).

Should the reservation with respect to section BG 1 be extended to apply to the proposed permanent establishment anti-avoidance rule (DD Appendix Para 4)?

If the reservation to Article 18 of the MLI for section BG 1 is to be made, it may be helpful in achieving policy aims and clarity for taxpayers if the reservation extends to the proposed permanent establishment anti-avoidance rule (*BEPS – Transfer pricing and permanent establishment avoidance*).

General

We trust you find our comments useful. If you have any questions, please contact us.

Yours sincerely



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18 April 2017

Supplementary submission: New Zealand's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

Dear Madam

Further to our submission dated 7 April 2017 on the implementation of the Multilateral Instrument (MLI) in NZ, we would like to make one further submission. We apologise for our original omission.

NZ should not elect to apply Article 4 of the MLI (Dual resident companies)

NZ should retain the tie breaker test for corporate tax residence in its double tax agreements. In our experience over the past 10 years, dual residence has generally arisen inadvertently where a company incorporated in one jurisdiction is effectively managed in another, and not as a result of tax planning. Removing the tie breaker test will introduce unnecessary uncertainty for a dual resident company.

Applying for a Competent Authority determination in this situation is a time consuming solution, particularly bearing mind delays already experienced by taxpayers when a tax authority in another jurisdiction is asked to certify their tax residence. A taxpayer faces uncertainty and is at risk of double tax during this time period, which it may find difficult to recover. For example, it can take more than 6 months for a taxpayer to get a certificate of residency from the IRS, and that is in a situation where the IRS is not required to reach agreement with any other competent authority.

Removal of the tie breaker test in favour of a competent authority decision will also place an unnecessary burden on competent authorities, which in many cases are already stretched for resources.

A number of NZ tax advantages which could be obtained by a company being a dual resident have been eliminated by NZ's domestic legislation already, such as an inability to use a loss to offset income of group companies, or join a tax consolidated group. Any residual concerns Officials have around the use of dual resident companies for tax avoidance purposes should be specifically dealt with in the pending hybrid rules.

We trust you find our comments useful. If you have any questions, please contact us.

Yours sincerely



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Our ref: 170410MLIsubmission

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 Inland Revenue Department
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10 April 2017

Dear Madam

KPMG submission - NZ's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

Multi-lateral instrument ("the MLI")

We welcome the opportunity to submit on New Zealand's implementation of the MLI.

Our submissions are more of a general nature than a detailed analysis of the MLI articles and New Zealand's position in respect of them. This is because of the time available but also because of the difficulty of determining what the MLI will actually achieve: this is dependent on New Zealand and other countries' positions. Both remain uncertain.

Ability to enter into the MLI

We acknowledge firstly that New Zealand's Government has the constitutional ability to decide New Zealand's tax treaty position. It therefore makes sense that its policy is achieved efficiently through the MLI so that our double tax agreements ("DTA") are aligned with that policy in the shortest time at the least cost.

Lack of transparency and consultation

Despite the constitutional position, it is also clear that in the current environment there is a demand for transparency and actual consultation for New Zealand's treaties. That has not occurred with New Zealand's decision to sign the MLI.

We refer to the public debate on the now defunct Trans-Pacific Partnership Agreement and also the United Kingdom court cases on the constitutional position to give effect to the Brexit referendum. The first clearly showed that a "trust us to do the right thing" approach is not widely accepted. The second shows that the Crown's position is not unfettered. The decision to enter into a treaty may be reserved to the Crown but its domestic effect must be given through Parliament. (This is also evidenced by Parliamentary Select Committee oversight of the tax treaty process.)

The MLI has been developed, in our view, with minimal consultation. (See for example the detailed consultation undertaken by the Australian Government by comparison.) The current consultation document does not make up for that. It is likely that implementation of the MLI will therefore be a "fait accompli".



Inland Revenue Department

KPMG submission - NZ's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

10 April 2017

We acknowledge that wider consultation may not have altered the decision (see our comments regarding global citizenship below) but such consultation is likely to have made the consequences of signing up to the MLI more transparent.

Inconsistency of “global citizen” approach

We understand the driver for New Zealand signing up to the MLI is to show it is a good global citizen to the OECD. Applying the global consensus, as articulated by the OECD’s BEPS Action plans, is required for this. This is not a completely altruistic position as it is expected that applying the global consensus will have beneficial effects for New Zealand’s tax system. (See the draft International Tax Strategy.)

However, at the same time, through the deemed Permanent Establishment (“PE”) and interest rate limitation proposals, New Zealand is proposing to depart from the global consensus.

The deemed PE rule is labelled as such but its features are the same as parts of the United Kingdom’s Diverted Profits Tax and Australia’s Multinational Anti-Avoidance rules. Both have been criticised as departures from the global consensus, which is to amend DTAs through the PE changes to be made by the MLI. The interest rate cap proposal is inconsistent with the global transfer pricing rules.

While we will be submitting in detail on the deemed PE and interest limitation issues, as a point of principle, this departure makes New Zealand’s policy contradictory and incoherent. That alone should give New Zealand pause for proceeding with those proposals.

Impact of non-acceptance of the MLI PE changes on the deemed PE proposals

The deemed PE rule is supported as an anti-avoidance rule. Specifically, as an anti-DTA PE avoidance rule.

As proposed (acknowledging that the proposal does not provide the legislative detail), PE avoidance is deemed to arise if certain features exist rather than applying a DTA PE avoidance test. The proposal is drafted in this way because an anti-avoidance rule overrides a DTA.

The effectiveness of this approach is doubtful if the country or jurisdiction of the non-resident does not agree to the PE changes in the MLI. Briefly, the argument is:

- The MLI provides all countries with the opportunity to modify the PE rules in their DTAs to meet the BEPS PE concerns.
- If a country does not agree to those changes, the PE rules agreed between that country and New Zealand will not be modified. The other country does not therefore accept that New Zealand has the right to tax where the proposed deemed PE rule would apply. (Equally, it also accepts that it does not have the right to tax for activities of New Zealand residents within the BEPS PE definition.)
- Given the lack of agreement, it seems to us that characterising the deemed PE proposals as an anti-avoidance rule (so that it can override a DTA) is mere labelling. Substantively, it is not an anti-avoidance rule as, using the domestic test, it cannot be contemplated that the two parties considered that the structure should not benefit from the DTA. The lack of a change to the DTA in fact supports the view that the parties continue to contemplate that the structure is effective.
- The relevant DTA may therefore still apply despite the deemed PE rule applying on its face.

(We further note that the relevant structure may impact a number of countries. The argument that New Zealand tax is not a purpose of the structure may also be made.)



Inland Revenue Department

KPMG submission - NZ's implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

10 April 2017

We can see no indication that this concern has been addressed. In our view, the impact on the deemed PE proposals of a DTA partner country not accepting the MLI's PE proposals needs to be carefully considered.

The lack of a principled approach by the OECD means over-taxation concerns are not addressed

In our submissions on the anti-hybrid mismatch proposals, we described the OECD's recommendations as "unprincipled". We noted that this was arguably necessary as a principled approach would have required a global consensus on the debt/equity and transparent/opaque treatment of instruments and entities. This unprincipled approach raises potential double taxation and inappropriate taxation problems.

A similar problem of an unprincipled approach arises with the MLI. It does not require all matters to be agreed, nor does it provide support for taxpayers seeking to apply an appropriate DTA.

Mutual Agreement Procedures ("MAP")

The MLI does not require mandatory arbitration by parties agreeing to other changes to their DTA. This leaves open the possibility that "bad faith" adjustments will be made by a country. This will leave taxpayers, who may otherwise accept the change in the global approach to taxing cross-border transactions, with the prospect of double taxation with no ready mechanism to fix the problem.

The simple (albeit probably naïve) response to constitutional concerns regarding the MAP is that if a country has:

- Signed up to a DTA; and
- Applies the DTA consistent with its agreements; then
- Arbitration should be of no concern as the arbitration should confirm their position.

New Zealand should require agreement to the MAP as a condition of a DTA becoming a "covered tax agreement" under the MLI.

Providing greater certainty of application of a DTA

Taxpayers experience difficulties in having other jurisdictions apply their DTA with New Zealand. This may be:

- As simple as the other country requiring forms and certifications to allow relief under the DTA to be claimed.
- As a result of differences in view of the status of a taxpayer. For example, whether a PIE or a "look through" entity is a New Zealand tax resident.
- By not applying a DTA in the way intended (e.g. to allow foreign tax credits where New Zealand has the right to tax).

We note that both US FATCA and the OECD's Automatic Exchange of Information ("AEOI") impose significant compliance obligations on New Zealand financial institutions. They do and will provide information to overseas jurisdictions of the activity of their residents in New Zealand. This should reduce the concern that New Zealand is being used as a conduit to inappropriately access DTAs.

In our view, New Zealand would be justified in making the application of the MLI to a particular DTA conditional on acceptance that New Zealand taxpayers include:



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- PEs and KiwiSaver schemes;
- Confirmation that a look through entity is also entitled to DTA relief.

Domestic impact of the MLI

The MLI will allow other countries to tax New Zealand connected activities where that would not currently be the case. This has the potential for double taxation because:

- New Zealand does not allow, or does not clearly allow, a foreign tax credit; and
- New Zealand does not allow a foreign tax credit for foreign tax which is paid indirectly.

The domestic foreign tax credit rules should be considered to ensure that foreign tax paid is available as a credit. The situations which should be considered include:

- A non-resident with New Zealand connected activity deriving foreign sourced income from that activity;
- Foreign income derived through intermediate entities;
- Taxes applied for investments in foreign companies, for which Foreign Investment Fund income is calculated under the Fair Dividend Rate method.

Further, the policy position that foreign tax credits should not be available for foreign income derived indirectly should be revisited.

Difficulty of determining the effect of the MLI and policy publications

New Zealand has not advised the countries it expects will agree to New Zealand's DTAs being covered tax agreements. Nor has it advised particular countries' positions on particular provisions of the MLI.

This makes it difficult to assess the impact of the MLI. This applies to the tax effects as well as to determining technical problems that may arise (see the deemed PE comments as a potential technical issue.)

Assuming that New Zealand will continue with its signalled approach, we consider that New Zealand should:

- Publish detailed commentary on its view of the effect of the MLI on covered tax agreements and the agreed modifications as soon as possible after a DTA partner country signs the MLI. This will be important to answer questions on the effect for a particular DTA. We note that New Zealand's DTA commentary is often very poor compared to those produced by the DTA counter-party. This means that the other country's position becomes the de facto explanation of the DTA and the reasons for the agreements made.
- Publish commentary on why particular DTAs are not covered tax agreements. For example, either New Zealand or the other country may prefer a bi-lateral negotiation (for whatever reason). This is important to answer questions regarding other BEPS proposals.
- Publish a consolidated version of the DTA which includes the agreed MLI amendments. This should be something that New Zealand does officially so that there is confidence in the versions which are published.



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Specific MLI provisions

It was not apparent from the issues paper that the application of the specific MLI articles is being consulted upon. We have made some comments and submissions on some of the MLI's proposals. We are aware that others will or have made submissions on specific articles. We would be happy to discuss the specific articles with you.

Conclusion

The MLI will significantly change New Zealand's approach to taxing cross-border transactions. It will allow New Zealand to tax certain transactions that it cannot currently while allowing other countries to tax New Zealand residents on certain transactions that they currently cannot.

Although the timetable is very tight (given a June signing), New Zealand needs to be clear that the MLI will achieve its desired effect. That will to a large extent depend on other countries being willing to sign the MLI and to accept positions consistent with New Zealand's position.

To the extent there is agreement, the position should be clearer. However, that will not be the case if there is no agreement. New Zealand needs to be ready to clearly state its position for those DTAs which are not affected.

We would be happy to discuss our submissions with you should that be helpful. Our contact numbers are 04 816 4518 (John Cantin) and 09 367 5940 (Darshana Elwela).

Yours sincerely

John Cantin
Partner

Yours sincerely

Darshana Elwela
National Tax Director



7 April 2017

New Zealand's implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*

C-/ Cath Atkins
Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Cath

NEW ZEALAND'S IMPLEMENTATION OF THE MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BEPS

The Corporate Taxpayers Group ("the Group") is writing to submit on the Officials' Issues Paper "New Zealand's implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*" (the "Issues Paper"). The Group appreciates the opportunity to submit on the Issues Paper and looks forward to further discussing the issues with officials.

Summary of our submission

The key points in our submission are:

- The Group is concerned that the MLI will see an unnecessary increase in complexity and compliance costs. As with all tax policy proposals, the Group believes that the adoption of the MLI needs to be considered in the context of the overall impact to the New Zealand economy and "NZ Inc.". This includes consideration of tax take, attractiveness of New Zealand as an investment destination and the ease of doing business in New Zealand. New Zealand enjoys a sought after reputation as being an easy country to do business with and undertake business in. It is paramount that this reputation is protected.
- The Group does not support New Zealand's adoption of all the substantive provisions in the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (the multilateral instrument or "MLI") as is proposed in the Appendix to the Issues Paper. Most of the proposed provisions are not minimum standards (i.e., there is no requirement that they be adopted), and in some cases the costs to New Zealand of including the provision in its Double Tax Agreements ("DTAs") would outweigh the benefit. We have (in Appendix Two to this letter) replicated the Appendix to the Issues Paper and summarised the Group's submissions on whether New Zealand should adopt each measure. Set out immediately below is an overview of the Group's submissions. Detailed comments expanding on the overview are set out in Appendix One.

Contact the CTG:

c/o Rebecca Osborn, Deloitte
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Wellington 6140, New Zealand
DDI: 04 470 3691
Email: rosborn@deloitte.co.nz

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.



- The Group considers that its measures should be adopted by New Zealand only if they will be in New Zealand's national interest. Where proposals replicate existing anti-abuse measures (thereby increasing compliance costs, but without achieving a corresponding benefit), the Group does not consider that these measures should be adopted.

Dual resident entities

- The Group does not support replacing the existing dual resident entity tie breaker provisions with a default rule that dual resident entities do not qualify for DTA relief unless the Competent Authorities agree. This amendment would not be in New Zealand's national interest. The mischief that the proposed rule targets is addressed by existing rules (and will be further addressed by the anti-avoidance provisions in the MLI). The proposed rule would, however, result in increased costs and uncertainty (and potentially double taxation) for companies that inadvertently become dual resident.
- If the amendments to the dual resident entity tie breaker provision are adopted, Inland Revenue should publish guidance on the Competent Authority process (including as to how New Zealand would apply that guidance in seeking to agree with the other affected country where a company will be resident for the purposes of the DTA). In addition, at least in the case of Australia (given the likelihood that most dual residence cases could be expected to arise between New Zealand and Australia) there should be a stream-lined application process or a self-assessment option based on published criteria for resolving dual residence cases.

Anti-avoidance provisions

- The Group acknowledges that the treaty anti-abuse rules in Article 7 of the MLI are a minimum standard and will therefore be adopted with the MLI. The Group does, however, consider that changes need to be made to New Zealand's domestic law to reduce overlap and the possibility of parallel proceedings being brought under both a DTA and the domestic law general anti-avoidance rule ("GAAR").
- The Group does not support the adoption of the dividend transfer transactions article (Article 8) of the MLI. This rule will cause administrative complexity for Inland Revenue and taxpayers. The Group considers that cases of manipulation of a shareholder's ownership interest to secure DTA relief can be addressed under Article 7 of the MLI. Article 8 would therefore add considerably to compliance costs for little, if any, benefit.
- The Group does not support the adoption of Article 9 of the MLI concerning land rich companies. As with Article 8, Article 9 would add considerably to compliance costs in circumstances where the cases in which it is intended to apply can be addressed by Article 7. In the alternative to our submission that Article 9 should not be adopted, if it is adopted, New Zealand should implement domestic law measures to reduce the additional compliance costs that will result (eg, by allowing quarterly asset values to be taken as representative of the asset values for each day in that quarter).



Artificial permanent establishment avoidance

- The Group submits that greater uncertainty will result from the expanded permanent establishment ("PE") definitions included in both the MLI and domestic law (see the proposed domestic law amendments in the Government discussion document "*BEPS — Transfer pricing and permanent establishment avoidance*"). The proposed domestic law PE rule should not apply in cases in which an arrangement is subject to (but not caught by) the broader PE definition (resulting from Part IV of the MLI) or the anti-abuse provisions in Part III of the MLI.

Dispute resolution

- The Group generally supports the amendments to the mutual agreement procedure ("MAP") and the provision for arbitration for cases not resolved by negotiation between the Competent Authorities. In order to make the amendments meaningful:
 - cases involving section BG 1 of the Income Tax Act 2007 ("ITA") should not be excluded from MAP and arbitration. To do so would effectively enable a country with a GAAR that is excluded from MAP and arbitration to also exclude from MAP and arbitration the extensive anti-abuse provisions included in the DTA, which would considerably weaken the DTA dispute resolution process; and
 - the Government should ensure that Inland Revenue is sufficiently resourced to meet the additional demands on its Competent Authority personnel that will result from the MLI.

Other matters

- Inland Revenue should publish on its website consolidated versions of each Covered Tax Agreement. Inland Revenue's compliance model is intended to be customer centric and to aid taxpayers in getting it right, first time. As such, Inland Revenue should invest the necessary resource to make consolidated versions of each Covered Tax Agreement available to all taxpayers.
- Inland Revenue should maintain a list on its website of "entry into effect for specific taxes" for each New Zealand Covered Tax Agreement so that taxpayers can easily determine from when a Covered Tax Agreement has been modified and the effective date of amendments to particular provisions.

Please contact us if you wish to discuss any of the matters raised in our submission.



For your information, the members of the Corporate Taxpayers Group are:

- | | |
|---|---|
| 1. Air New Zealand Limited | 21. New Zealand Racing Board |
| 2. Airways Corporation of New Zealand | 22. New Zealand Steel Limited |
| 3. AMP Life Limited | 23. New Zealand Superannuation Fund |
| 4. ANZ Bank New Zealand | 24. Opus International Consultants Limited |
| 5. ASB Bank Limited | 25. Origin Energy New Zealand Limited |
| 6. Auckland International Airport Limited | 26. Pacific Aluminium (New Zealand) Limited |
| 7. Bank of New Zealand | 27. Powerco Limited |
| 8. Chorus Limited | 28. Shell New Zealand (2011) Limited |
| 9. Contact Energy Limited | 29. SKYCITY Entertainment Group Limited |
| 10. Downer New Zealand Limited | 30. Sky Network Television Limited |
| 11. Fisher & Paykel Healthcare Limited | 31. Spark New Zealand Limited |
| 12. Fletcher Building Limited | 32. Summerset Group Holdings Limited |
| 13. Fonterra Cooperative Group Limited | 33. Suncorp New Zealand |
| 14. Genesis Energy Limited | 34. T & G Global Limited |
| 15. IAG New Zealand Limited | 35. The Todd Corporation Limited |
| 16. Infratil Limited | 36. Vodafone New Zealand Limited |
| 17. Lion Pty Limited | 37. Watercare Services Limited |
| 18. Meridian Energy | 38. Westpac New Zealand Limited |
| 19. Methanex New Zealand Limited | 39. Z Energy Limited |
| 20. New Zealand Post Limited | 40. ZESPRI International Limited |

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

John Payne
For the Corporate Taxpayers Group



APPENDIX ONE: DETAILED SUBMISSION POINTS

1. General comments

- 1.1 The Group is concerned that the MLI will see an unnecessary increase in complexity and compliance costs. As with all tax policy proposals, the Group believes that the adoption of the MLI needs to be considered in the context of the overall impact to the New Zealand economy and "NZ Inc.". This includes consideration of tax take, attractiveness of New Zealand as an investment destination and the ease of doing business in New Zealand. New Zealand enjoys a sought after reputation as being an easy country to do business with and undertake business in. It is paramount that this reputation is protected.
- 1.2 The Group considers that its measures should be adopted by New Zealand only if they will be in New Zealand's national interest. Where proposals replicate existing anti-abuse measures (thereby increasing compliance costs, but without achieving a corresponding benefit), the Group does not consider that these measures should be adopted. It is with this background that the Group makes the following submissions.

2. Changes to rules for determining residence OF (and DTA benefits available to) a dual resident entity (Article 4)

Proposal is based on an incorrect assumption as to how cases of dual residence may arise

- 2.1 The Issues Paper proposes to replace tie breaker provisions in existing DTAs with a provision requiring the Competent Authority of each state in which the dual resident entity is resident, to "endeavour to determine by mutual agreement" in which state the entity will be deemed to be resident for the purpose of the DTA.¹ The Group considers that this measure would reduce certainty, impose additional compliance costs and increase the risk of double taxation for New Zealand businesses in circumstances where the dual residence often results from inadvertence and does not secure a tax benefit.
- 2.2 The changes to the dual resident entity tie breaker test are predicated on the assumption that cases of dual residence often involve tax avoidance.² This assumption is not reflective of the reality, at least in New Zealand. Cases of dual residence more commonly arise due to inadvertence or unavoidable changes in circumstances; in fact, so far as tax planning is concerned, the usual practice is for companies to plan not to be dual resident.

¹ The Issues Paper at page 15, in discussing the effect of Article 4 of the MLI and the consequences of the Competent Authorities agreeing tax residence, states that "[t]he proposed provision will require [Competent Authorities] to agree the residence status of a [dual resident entity] **and** the [dual resident entity] will only be entitled to such treaty benefits as the CAs agree" [emphasis added]. This might be interpreted as suggesting that the Competent Authorities must first agree whether the dual resident should be deemed resident (for DTA purposes) in one or other country and then decide which treaty benefits will be allowed as a result of that residence status. This should be clarified in future Inland Revenue statements so it is clear that if the Competent Authorities agree that the dual resident is resident in a given country for DTA purposes, relief under the DTA is allowed accordingly, and only in cases where they do not so agree will it be necessary for them to determine to what extent, if any, DTA relief should be allowed. The necessary clarification could be achieved by replacing "and" (where emphasised in the quote from the Issues Paper above) with "or".

² OECD, "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: Final Report" (OECD Publishing, Paris, 2015) at [47] (page 72). The Report states that the view of many countries was that "cases where a company is a dual-resident often involve tax avoidance arrangements".



- 2.3 A typical scenario in which dual residence could arise due to inadvertence could involve an Australian incorporated subsidiary ("Aus. Co") of a New Zealand resident company ("NZ Co"). Aus. Co is intended to be tax resident solely in Australia, and so it holds its directors' meetings in Australia and has its senior executives located in (and making management decisions in) Australia. Subsequently, however, directors of Aus. Co who are based in New Zealand make strategic and management decisions for Aus. Co without formal directors' meetings being convened in Australia. This results in Aus. Co being resident in New Zealand under section YD 2(1)(d) of the ITA because "its directors... exercise control of [Aus. Co] in New Zealand, even if the directors' decision-making also occurs outside New Zealand" (i.e., it is enough that some decision-making at director level occurs in New Zealand for the company to be deemed tax resident in New Zealand). The entity is therefore dual resident (in Australia due to incorporation and in New Zealand under section YD 2(1)(d)).
- 2.4 Dual residence in the above example arises inadvertently. The scenario will often affect businesses expanding their operations across borders for the first time, who are not as experienced in managing cross-border tax issues. Presently, most DTAs will provide a solution; the entity will be deemed to be tax resident in the country where it has its place of effective management, and will be entitled to DTA relief on that basis. The result of the proposed rule is that entities like this Aus Co will be entitled to no DTA relief from double taxation unless the Competent Authorities of New Zealand and Australia agree otherwise.

Proposal will lead to greater uncertainty and cost and increased incidence of double taxation

- 2.5 Currently, most DTAs to which New Zealand is party contain a dual resident tie-breaker provision. The most common tie breaker provision, contained in both the UN Model DTA (Article 4) and OECD Model DTA (Article 4), is the place of effective management test. The place of effective management test allows a taxpayer to determine the jurisdiction in which they will be resident for the purposes of the DTA by reference to a single criterion.
- 2.6 This has two beneficial consequences: (i) it allows taxpayers to plan appropriately and conduct risk assessments when expanding business offshore; and (ii) taxpayers can "self-assess" their tax residence for the purposes of their tax returns and pay the right amount of tax in the right jurisdiction. The adoption of Article 4 of the MLI will make it more difficult to plan and assess the risk of a proposed expansion and will make it impossible for dual resident companies to self-assess their tax liability without first approaching the Competent Authorities.
- 2.7 The Group considers this unsatisfactory. The Government's Business Growth Agenda calls for opportunities for business to grow internationally by reducing domestic and offshore barriers to internationalisation.³ The proposed amendments to the tie-breaker test seem counter-productive in this regard.

³ See Ministry of Business, Innovation and Employment "The Business Growth Agenda: Towards 2025" (Ministry of Business, Innovation and Employment, Wellington, 2015).

- 2.8 The uncertainty will result in additional costs for taxpayers who find themselves to be dual resident. These costs will be in the form of: (i) double taxation, and/or (ii) administrative costs in requesting the assistance of the Competent Authority. In some cases, the costs of seeking Competent Authority assistance will be such that taxpayers will instead accept the denial of DTA relief. For smaller businesses considering expanding offshore, the increased risk of double taxation will be a barrier to doing so.
- 2.9 Further, Inland Revenue, too, will be subject to increased uncertainty if Article 4 is adopted, and will incur increased costs due to increased demands on the Competent Authority. Competent Authorities are already under pressure to resolve disputes under the general DTA resolution process the Mutual Agreement Procedure ("MAP") process. The current average time period for resolving a MAP complaint is 20 months.⁴ While the Group recognises that the provision requiring Competent Authorities to agree in cases of dual residence is not strictly the same as MAP, the statistic nonetheless indicates that any process requiring the agreement of the Competent Authorities is unlikely to be rapidly concluded, and that further adding to the responsibilities of the Competent Authorities could result in longer timeframes generally.

The mischief is addressed by other measures

- 2.10 Considering the complexity of the amendments and the extra burden that would be imposed on Inland Revenue and taxpayers, the Group considers it important to identify the mischief that the proposed rule is designed to prevent, and consider whether that mischief is sufficiently problematic to justify the increased cost and compliance costs. On this basis, the Group considers that the proposal does not pass the cost-benefit test and so is not in New Zealand's national interest.
- 2.11 Domestic law already contains measures to prevent tax avoidance by dual resident companies. Loss offsets by a dual resident company are precluded by section IC 7 of the Income Tax Act 2007 ("ITA") and the consolidation rules in section FM 31(1)(e) of the ITA preclude a dual resident company from joining a consolidated group (an alternative mechanism to offset losses). The anti-hybrid proposals also include measures to prevent double deductions and other hybrid mismatches stemming from hybrid mismatch arrangements. The Group submits therefore, that the mischief the proposed rule is trying to address is already addressed by other provisions of New Zealand's domestic law and by other proposals under consideration and should not be introduced into New Zealand's DTA network.
- 2.12 Further, the MLI will introduce broadly worded anti-abuse provisions into DTAs to which the MLI applies. This will mean that within the DTA itself, as well as under domestic law, there will be provisions to address any cases in which dual resident companies are being used to secure DTA relief in inappropriate circumstances.

⁴ See OECD "Mutual Agreement Procedure Statistics for 2015" <http://www.oecd.org/tax/dispute/map-statistics-2015.htm> (accessed 29 March 2017).



Alternative submission: proposed solution if the dual resident tie breaker amendment is adopted

- 2.13 If the Government nevertheless considers it necessary to adopt the proposed rule, the Group proposes the following suggestions with a view to reducing the cost and uncertainty that will result:
- (a) Inland Revenue should issue guidance to taxpayers setting out New Zealand's position as to when the New Zealand Competent Authority would consider an entity should be tie-broken into one or other country (ie, what are the factors that the New Zealand Competent Authority would consider when negotiating with other Competent Authorities on the question of where a dual resident entity should be agreed to be resident).
 - (b) For states with which New Zealand has significant trading relations and in respect of which taxpayers are at greatest risk of becoming dual resident (eg, Australia), Inland Revenue should seek to negotiate a formal, public MAP decision which will set out the criteria by which dual resident entities can "self-assess" residence without having to be subject to double taxation or incur the costs of requesting Competent Authority assistance. The Group would be happy to discuss this proposal further with officials.

3. Treaty anti-abuse rules

Overview

- 3.1 The treaty anti-abuse rules in Article 7 of the MLI are a minimum standard. Of the three options available under the MLI, the principal purpose test ("PPT") appears to the Group to be most in keeping with New Zealand's existing DTA practice and domestic law. The Group therefore accepts the appropriateness of New Zealand opting for the PPT test in Covered Tax Agreements.
- 3.2 The Group is concerned, however, that given the multiple layers of anti-avoidance measures being proposed, much greater uncertainty for taxpayers could result, for no demonstrable benefit for New Zealand. The Group's submissions that follow therefore suggest a rationalisation of the potential multiple layers of anti-abuse rules introduced in the MLI, and guidance as to the relationship between the PPT that will be introduced by the MLI and the domestic law general anti-avoidance rule ("GAAR") in section BG 1 of the ITA.

Dividend transfer transactions (Article 8)

- 3.3 The Group does not support the adoption of the dividend transfer transactions article (Article 8) of the MLI. This 365-day ownership requirement will cause administrative complexity for Inland Revenue and taxpayers. Any cases of manipulation of a shareholder's ownership interest to secure DTA relief can be addressed under Article 7 of the MLI. Article 8 would therefore add considerably to compliance costs for little, if any, benefit.



- 3.4 In the alternative to our submission above that Article 8 should not be adopted, if Article 8 is adopted, Inland Revenue should release guidance as to how the rule will work in practice and should consider domestic law amendments to facilitate compliance with Article 8. In particular, is it intended that the shareholder receive the benefit of the lower withholding rate at source only if it has already held the required shareholding for 365 days before the dividend is paid? In that case, where the higher rate is applied and the shareholder subsequently passes the 365-day period, the shareholder would need to seek a refund of over-deducted tax. Alternatively, can a company, when paying a dividend, rely on a representation that the shareholder intends to hold the interest for 365 days? In that case, any additional source country tax payable by the shareholder should the shareholder not hold the required interest for the full 365-day period should be the responsibility of the shareholder, not of the company that has paid the dividend.
- 3.5 The administrative complexities associated with the proposed rule demonstrate the merit in our primary submission. That is, in view of the wide reaching PPT test, any benefit in adopting the rule is outweighed by the costs, such that it should not be adopted by New Zealand.

Land rich company rules (Article 9)

- 3.6 The land rich company test (eg, whether more than 50% of the value of shares in the company is derived from real property) is intended to permit a source country to tax gains on the disposal of shares in a company the value of which is mainly attributable to land situated in the source country. The proposal is that a land rich test be required to be applied on each day of the 365-day period preceding a disposal to which the alienation of property article in the DTA might apply. The concern apparently underlying Article 9 is that the company's assets can be manipulated prior to a disposal of its shares so the value of real property falls below the threshold (say 50%).
- 3.7 The Group does not support the adoption of the rule in Article 9 of the MLI. As with Article 8, Article 9 would add to compliance costs in circumstances where the scenarios in which it is intended to apply can be addressed by Article 7.
- 3.8 In the alternative to our submission that Article 9 should not be adopted, if it is adopted, New Zealand should implement domestic law measures to reduce the additional compliance costs that will result (eg, by allowing quarterly asset values to be taken as representative of the asset values for each day in that quarter).

Guidance as to the relationship between the PPT and section BG 1 of the ITA

- 3.9 Recent amendments to section BH 1 of the ITA provide that (in contrast to the usual position, that a DTA has effect despite anything in the ITA) a DTA (including its dispute resolution provisions) will not override section BG 1. Yet the MLI would introduce to Covered Tax Agreements a PPT which on the face of it is intended to operate as the DTA equivalent of section BG 1.



- 3.10 This layering of anti-avoidance provisions (one regime (the PPT) contained in the DTA, and a second (section BG 1) contained in domestic law and expressed to override the DTA) will be problematic. Countries party to a DTA which incorporates the PPT could reasonably expect that the PPT should be the reference point for determining whether an arrangement should be considered abusive such that DTA relief otherwise available should be denied. If a taxpayer satisfies (ie, is not caught by) the very broad PPT in a Covered Tax Agreement, it would be reasonable for that taxpayer to conclude that DTA relief should not then be denied unilaterally by New Zealand under section BG 1, the domestic law counterpart to the DTA's PPT.
- 3.11 The correct policy result is that if a taxpayer satisfies (ie, is not caught by) the PPT in a Covered Tax Agreement, it should not be open for Inland Revenue to invoke section BG 1 to unilaterally deny DTA relief otherwise available. This could be achieved by:
- (a) amending section BH 1(4) so that the reference to section BG 1 applies "other than in the case of a double tax agreement that contains or is subject to Article 7 of the MLI or an anti-abuse rule substantially similar to Article 7 of the MLI"; and/or
 - (b) Inland Revenue issuing guidance (in the form of a Standard Practice Statement) to the effect that Inland Revenue will not invoke section BG 1 to deny DTA relief otherwise available to a taxpayer if the DTA contains or is subject to Article 7 of the MLI or an anti-abuse rule substantially similar to Article 7 of the MLI.

4. Preventing the artificial avoidance of permanent establishment status

- 4.1 The Group is concerned by the uncertainty (and increased risk of double taxation) that will result from layers of rules intended to extend the reach of the PE definition. For some DTAs, the MLI amendments may apply, and in respect of all DTAs, the separately proposed domestic law PE avoidance rule could apply.
- 4.2 Further consideration should be given to the relationship between these measures and to the uncertainty that will result from multiple layers of rules with the same broad objective. The Group submits that Inland Revenue should include a provision in the proposed domestic PE avoidance rule confirming that if an entity does not have a PE under the provisions of a DTA containing the expanded PE definition (Part IV of the MLI) read with the anti-abuse provisions in Part III of the MLI, then the domestic law PE avoidance rule will not apply.

5. Improved mechanism for effective dispute resolution

Greater resourcing will be required to meet the increase in cases requiring Competent Authority involvement

- 5.1 The Group supports the amendments to MAP and the inclusion of arbitration. But for the improvements to dispute resolution to be meaningful, the Government must ensure that the Competent Authority is sufficiently resourced to meet the expected increase in cases requiring Competent Authority determination, and/or which are referred to MAP and arbitration.



GAAR should not be excluded from arbitration

5.2 The Group also submits that cases involving the GAAR should not be excluded from the arbitration process. The introduction of the PPT will mean that affected DTAs will have embedded in them very similar concepts to the concepts underlying the GAAR. (See further the discussion at paragraphs 3.9 to 3.11 above.) Accordingly, the correct policy outcome is that any disputed denial of DTA relief, whether in reliance on the PPT (in the DTA) or in reliance on the GAAR, should be subject to the same disputes resolution process in the DTA.

5.3 The OECD appears to have recognised the same point in its BEPS Action 14 Final Report, in recommending that whether DTA relief should be denied (whether under a DTA *or* a domestic law anti-abuse provision) should not be for one country to determine unilaterally, but rather should be able to be referred to MAP:⁵

*Countries should provide MAP access in cases in which there is a disagreement between the taxpayer and the tax authorities making the adjustment **as to whether the conditions for the application of a treaty anti-abuse provision have been met or as to whether the application of a domestic law anti-abuse provision is in conflict with the provisions of a treaty.***
[Emphasis added]

5.4 If the GAAR is excluded from arbitration, any dispute as to the application of a DTA which raises questions under a PPT could likewise be excluded from arbitration, since Inland Revenue could be expected to invoke the GAAR in parallel with the PPT. This would materially limit the value of the arbitration provision, and lead to disputes being pursued through parallel processes (some issues via MAP and arbitration, and some via the courts). Further, to exclude consideration of the GAAR from arbitration would significantly diminish the utility of MAP, since arbitration is in effect an enhancement to MAP, providing increased assurance the MAP will lead to an outcome.

5.5 Excluding the GAAR from the provisions of MAP and arbitration is, in the Group's view, contrary to the purpose of MAP and arbitration as an alternative dispute resolution process. The BEPS Action 14 Final Report emphasised that the MAP was to provide a disputes resolution process which was an alternative to and "independent from the ordinary legal remedies available under domestic law".⁶

5.6 Many states will require that domestic law processes be stayed before they will consider a MAP complaint. If Inland Revenue invokes the GAAR in parallel with invoking the PPT, and the GAAR question cannot be subject to MAP and arbitration, then the domestic law proceedings may not be stayed, further complicating the taxpayer's access to MAP and arbitration on other issues.

⁵ OECD "Making Dispute Resolution Mechanisms More Effective, Action 14: Final Report" (OECD Publishing, Paris, 2015) at recommendation 1.2 [emphasis added].

⁶ OECD "Making Dispute Resolution Mechanisms More Effective, Action 14: Final Report" (OECD Publishing, Paris, 2015) at [10].



- 5.7 Finally, to exclude the GAAR from arbitration raises the prospect that New Zealand and other countries might be able to tactically invoke the GAAR as a means of preventing the taxpayer from accessing MAP and arbitration in the very cases in which those processes may be of most value to the taxpayer. This would leave the taxpayer, in such cases, without access to MAP (a process which the OECD has described as being "of fundamental importance to the proper application and interpretation of the [DTA]").⁷ It would also mark a less cooperative (and more unilateral) approach to international base erosion and profit-shifting concerns, in contrast to the cooperative approach New Zealand has supported to date.

6. Other matters

- 6.1 Inland Revenue should publish on its website consolidated versions of each Covered Tax Agreement. This would be consistent with Inland Revenue's compliance model which is intended to be customer centric and to assist taxpayers in getting it right. Taxpayers should have equal access to DTAs and should not need to pay for copies in an easy to understand format or to rely on commercial publishers to make consolidated versions available
- 6.2 Inland Revenue should maintain a list on its website of "entry into effect " for each New Zealand Covered Tax Agreement so that taxpayers can easily determine the effective date(s) of the application of the MLI for a Covered Tax Agreement.

⁷ OECD "Making Dispute Resolution Mechanisms More Effective, Action 14: Final Report" (OECD Publishing, Paris, 2015) at [10].



APPENDIX TWO: SUBSTANTIVE BEPS PROVISIONS IN THE MULTILATERAL INSTRUMENT AND CTG COMMENTS

BEPS measure	Detail	Minimum standard	Should NZ adopt?	CTG Comment
1. Neutralising the effects of hybrid mismatch arrangements that have a treaty aspect (Action 2 report)	<p>Fiscally transparent entities The MLI introduces or amends a fiscally transparent entity (FTE) provision. FTEs (like trusts or partnerships) create arbitrage opportunities because they are treated differently for tax purposes by different countries. The MLI provision clarifies that treaty benefits will only be allowed to the extent to which the item of income is taxed in the state in which the entity is resident. New Zealand already includes this provision (or an equivalent provision) in its DTAs with Australia, United States, Chile and Japan.</p> <p><i>Article 3 of the MLI</i></p> <p>Dual resident entities The MLI introduces or amends a dual resident entity (DRE) tie breaker provision. Like FTEs, DREs can be used to take advantage of arbitrage opportunities. The proposed provision will require CAs to agree the residence status of a DRE and the DRE will only be entitled to such treaty benefits as the CAs agree.</p> <p><i>Article 4 of the MLI</i></p> <p>Relief of double taxation The MLI allows countries to strengthen their application of the exemption method to relieve double taxation. New Zealand already applies the (more robust) credit method in all of its DTAs, and therefore proposes not to adopt any of the options.</p> <p><i>Article 5 of the MLI</i></p>	No	Yes	—
2. Preventing the granting of treaty benefits in inappropriate circumstances	<p>Preamble language – minimum standard The MLI will amend the preamble to DTAs to emphasise that as well as aiming to relieve double taxation, the treaty also aims to prevent opportunities for non-taxation, reduced taxation or tax avoidance.</p> <p><i>Article 6(1) and (2) of the MLI</i></p>	Yes	Yes	—



BEPS measure	Detail	Minimum standard	Should NZ adopt?	CTG Comment
(Action 6 report)	Preamble language – optional amendment The MLI allows countries to adopt the following optional amendment to the preamble to DTAs: "Desiring to further develop their economic relationship and to enhance their co-operation in tax matters," <i>Article 6(3) and (6) of the MLI</i>	No	Yes	—
	Treaty anti-abuse rules The MLI requires jurisdictions to introduce an anti-abuse rule into DTAs. Jurisdictions can meet this minimum requirement in one of three ways: 1. a principal purpose test (PPT) alone; 2. a PPT plus a "simplified limitation on benefits" (LOB) clause. The LOB is a mechanical provision that seeks to identify, through a series of black-letter tests, whether a person is genuinely entitled to the benefits of a DTA; or 3. enter into bilateral negotiations to include a detailed LOB provision plus a PPT or anti-conduit rules. In the case of New Zealand, officials' favour adopting a PPT alone. The PPT is very similar to New Zealand's domestic law GAAR and will deny treaty benefits if the principal purpose of an arrangement was to secure those benefits. Also, in officials' view, it generally covers the same treaty shopping issues as the alternative approaches. <i>Article 7 of the MLI</i>	Yes	Yes	The Group acknowledges that the anti-abuse rules are a minimum standard and will be adopted with the MLI. The Group does consider however, that the domestic law amendments and/or guidance may be required to provide for the relationship between the PPT and GAAR.
	Dividend transfer transactions The MLI introduces a provision that requires shares to be held for a minimum of 365 days for the shareholder to be entitled to the reduced withholding tax (WHT) rates on dividends. This is to stop shareholders buying shares temporarily to access the reduced WHT rates and then immediately selling them. <i>Article 8 of the MLI</i>	No	Yes	The Group does not consider this amendment is necessary in light of the adoption of the PPT and the increased complexity and costs it will lead to.



BEPS measure	Detail	Minimum standard	Should NZ adopt?	CTG Comment
Land rich company rules	<p>The MLI introduces a treaty provision that strengthens the anti-abuse “land-rich company” test (land rich companies are companies whose assets are mainly land). Some treaties do not contain this provision at all, so the MLI also allows it to be inserted into those treaties.</p> <p>The new rule reinforces the position that the source jurisdiction can tax land held by non-resident owners in the other jurisdiction through corporate vehicles. To prevent artificial and temporary dilution of the amount of land held by a company just before sale, the MLI provision requires the threshold for the amount of land ownership which triggers the rule to be measured on every day in the 365 day period leading up to the sale of the shares.</p> <p>The MLI provision also ensures the same rule applies to other investment vehicles such as partnerships and trusts.</p>	No	Yes	<p>The Group does not consider this amendment is necessary in light of the adoption of the PPT and the increased complexity and costs it will lead to.</p> <p>Alternatively, if this article is adopted, the Group proposes that provisions should be provided in domestic law to ensure that compliance costs are reduced.</p>
Article 9 of the MLI		No	Yes	—
Third-state PE rules	<p>The MLI introduces a treaty provision that denies treaty benefits in the case of income derived by a PE of a resident of one of the parties to the DTA, where that PE is situated in a low tax third-state.</p>	No	Yes	—
Article 10 of the MLI		No	Yes	—
Right to tax own residents	<p>The MLI introduces a provision that preserves a jurisdiction’s right to tax its own residents (for example, this prevents New Zealand residents engaged in a tax avoidance arrangement claiming a DTA prevents New Zealand from using the domestic law GAAR to impose tax).</p>	No	Yes	—
Article 11 of the MLI				



BEPS measure	Detail	Minimum standard	Should NZ adopt?	CTG Comment
3. Preventing the artificial avoidance of PE status	<p>Commissionnaire arrangements and similar strategies Currently, a number of artificial structures including the civil law concept of a "commissionnaire" can be used to avoid having a PE in a jurisdiction. A new provision will deem non-residents using these structures to have a PE in the jurisdiction.</p> <p><i>Articles 12 and 15 of the MLI</i></p> <p>Specific activity exemptions – preparatory and auxiliary qualification Certain specific activities carried on in a jurisdiction are deemed not to constitute a PE (for example, premises used for simply storing goods or stock maintained for display or delivery). These specific carve-outs from the PE definition allowed quite substantial economic activities to fall within them. The MLI proposes clarifying that the specific carve-outs listed in the DTA must be subject to an additional requirement that they be "preparatory and auxiliary" in nature. There are two options for dealing with this issue – Option A (which New Zealand favours) which subjects all of the existing specific activities to an explicit "preparatory and auxiliary" test, and Option B, which does not subject the specific activities to the "preparatory and auxiliary" test (because these activities are considered to be inherently preparatory and auxiliary in nature), but subjects any other activity or combination of activities to the "preparatory and auxiliary" test.</p> <p><i>Articles 13 and 15 of the MLI</i></p>	No	Yes	—
	<p>Specific activity exemptions – Anti-fragmentation rule The MLI introduces an "anti-fragmentation" rule that will prevent an enterprise from dividing up all of its activities so that related parties each carry on a separate part of the business (that fall within the PE exceptions), but taken together they constitute a PE.</p> <p><i>Articles 13 and 15 of the MLI</i></p>	No	Yes	—



BEPS measure	Detail	Minimum standard	Should NZ adopt?	CTG Comment
	Anti-contract splitting rule Currently a construction, installation or building project does not constitute a PE unless it last for more than 12 months. Entities were abusing this 12 month limit by having back-to-back 12 month contracts so they never exceeded the 12 month threshold. Generally the contracts were undertaken by different companies within the same group of companies. The new “anti-contract splitting” rule will aggregate related projects to prevent PE avoidance.	No	Yes	—
	<i>Articles 14 and 15 of the MLI</i>			
4. Providing improved mechanisms for effective dispute resolution	MAP – access to the CAs of either jurisdiction In Covered Tax Agreements that do not already have it, the MLI will introduce a provision allowing taxpayers to request mutual agreement procedure (MAP) in cases where they believe taxation is not in accordance with the treaty. If a MAP provision is already contained in a DTA, the MLI will amend it to allow taxpayers to approach the CA of either jurisdiction to resolve uncertainty as to how the DTA applies (New Zealand’s DTAs currently contain MAP provisions, but taxpayers are only entitled to approach the CA of the jurisdiction of which they are a resident).	Yes	Yes	The Group supports the adoption of the MLI articles relating to MAP. These amendments will ensure that taxpayers have greater access to MAP.
	<i>Article 16 of the MLI</i>			
	MAP – corresponding adjustment Requires contracting states to make appropriate corresponding adjustments in transfer pricing cases.	No	Yes	—
	<i>Article 17 of the MLI</i>			
	Arbitration If, under the MAP process, the CAs do not agree on the correct interpretation of the DTA, the CAs can submit the matter to an independent arbitrator (or a panel of three arbitrators) for decision. The arbitrators will decide which of the CAs is correct. The CAs are generally bound by the decision of the arbitrators, but the taxpayer is not. Therefore, the taxpayer could pursue a court case if it disagrees with the arbitrators’ decision.	No	Yes	The Group supports the adoption of the MLI articles relating to arbitration.



BEPS measure	Detail	Minimum standard	Should NZ adopt?	CTG Comment
	<p>New Zealand's approach is to adopt what is referred to as "final offer" or "last best offer" arbitration (in Article 23(1)), but to accept "independent opinion" arbitration if the other party to the Covered Tax Agreement chooses this (by entering a reservation under Article 23(2)). In the case of "independent opinion" arbitration, New Zealand will adopt Article 24(2) and (3) which means that the arbitrators' decision will not be binding on the CAs if they come to an alternative resolution of all unresolved issues within 3 calendar months of the delivery of the arbitrators' decision.</p> <p>New Zealand also proposes to require undertakings of confidentiality by all parties involved in arbitration (Article 23(5)) and reserves the right not to include arbitration provisions in Covered Tax Agreements with jurisdictions that do not require the same (Article 23(6) and (7)).</p> <p>New Zealand intends to enter a free form reservation in respect to arbitration to carve out cases that involve the application of New Zealand's general anti-avoidance rule contained in section BG 1 of the Income Tax Act 2007.</p> <p><i>Articles 18 – 26 of the MLI</i></p>			MAP and arbitration should be available as independent and alternative dispute resolution processes. Accordingly, section BG 1 should not be excluded from the scope of the arbitration provisions.



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New Zealand's implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

7 April 2017

Email: policy.webmaster@ird.govt.nz

Dear Sir

Submissions on New Zealand's implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*

We refer to the officials' issues paper, "New Zealand's implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*", which was released for consultation on 3 March 2017 ("IP"). We appreciate the opportunity to comment and do so below and, in more detail, in the attached Appendix.

Overall we support the implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* ("MLI") in New Zealand as a relatively simple way to enact various international obligations to which New Zealand has committed. We also agree that the MLI should be implemented as widely as possible, taking up minimum standards and virtually all optional articles, with few reservations.

However, there are issues which Inland Revenue should address in order to ensure the MLI is implemented in an efficient manner with minimal uncertainty and compliance costs. We respond to the specific questions posed for submission below, followed by comments on some other matters we believe require consideration.

All legislative references are to the Income Tax Act 2007 ("ITA"), unless otherwise stated.

Domestic law changes

Various amendments are required to the domestic disputes procedure rules in order for the mutual agreement procedure ("MAP") to work coherently alongside the existing domestic disputes procedure in the Tax Administration Act 1994 ("TAA"). These changes are largely required to ensure it is not necessary to invoke the domestic disputes procedure at the same time as carrying out the MAP:

- ▶ The response period in section 89AB of the TAA should either be extended or suspended when the taxpayer requests the Commissioner to invoke MAP.
- ▶ MAP could alternatively/additionally be treated as an alternative to the domestic disputes procedure.
- ▶ In the event of a taxpayer commencing MAP and a domestic dispute, the existing four year time period in section 89P of the TAA should be suspended.
- ▶ Rules regarding Commissioner initiated disputes may need amendment.
- ▶ Section 138I of the TAA should be extended to all disputed tax which is subject to MAP.
- ▶ The taxpayer right to request to opt-out of the disputes procedure should be extended to include international disputes.

Implementation

To assist with implementation:

- ▶ Inland Revenue should provide guidance on the interaction between "treaty abuse" under the MLI and "tax avoidance"/the general anti-avoidance rule ("GAAR") under section BG 1.
- ▶ We note New Zealand's intent to enter a free form reservation with respect to arbitration carve out cases that involve the application of section BG 1. Although arbitration does not have jurisdiction over section BG 1 (being a domestic law matter), it is important for arbitration to be available to resolve disputes about the application of DTAs to the (reconstructed) "facts" arising from a BG 1 / GB 1 assessment.
- ▶ DTAs currently being renegotiated should be included as Covered Tax Agreements ("CTAs").

Minimising uncertainty and compliance costs

In relation to practical options for minimising uncertainty and compliance costs:

- ▶ We anticipate an increase in the number of DTA disputes and cases of double taxation following the implementation of the MLI. Inland Revenue may need to increase the level of resources available to competent authorities in respect of MAP cases.
- ▶ Inland Revenue should consider producing consolidated Double Tax Agreement ("DTA") texts.

Other matters for consideration

- ▶ New Zealand's domestic law around the attribution of profits is likely to change as a result of BEPS initiatives. Taxpayers would likely benefit from some Inland Revenue commentary/guidance around New Zealand's approach to profit attribution given the proposed changes to the permanent establishment definition.
- ▶ The MLI may have a greater impact on New Zealand outbound investors than it does on inbound investors into New Zealand, where outbound investment is into jurisdictions with less sophisticated domestic law and DTA networks. The Government should not assume any additional net revenue as a result of the MLI.
- ▶ Further explanation is required regarding the difference in approach between Australia and New Zealand in respect of third-state permanent establishment rules (Article 10).

We would be happy to discuss any aspect of our submissions with you. Please contact David Snell (david.snell@nz.ey.com) in the first instance in that regard.

Yours faithfully



Aaron Quintal
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Appendix

Amendments to disputes procedure

We submit:

- ▶ The response period in section 89AB of the TAA should either be extended or suspended when the taxpayer requests the Commissioner to invoke MAP.
- ▶ MAP could alternatively/additionally be treated as an alternative to the domestic disputes procedure.
- ▶ In the event of a taxpayer commencing MAP and a domestic dispute, the existing four year time period in section 89P of the TAA should be suspended.
- ▶ Rules regarding Commissioner initiated disputes may need amendment.
- ▶ Section 138I of the TAA should be extended to all disputed tax which is subject to MAP.
- ▶ The taxpayer right to request to opt-out of the disputes procedure should be extended to include international disputes.

Various amendments are required to the domestic disputes procedure rules in order for the MAP to work coherently alongside the existing domestic disputes procedure in the TAA.

The interrelationship between MAP and the domestic disputes procedure will be of concern to taxpayers. For instance, in the event a dispute arises over the interpretation or application of the DTA, should the taxpayer seek to apply domestic procedures or MAP? Currently these procedure are run simultaneously which can be a costly, time consuming and inefficient process for taxpayers. In our experience, this double handling has acted as a disincentive for taxpayers to initiate MAP.

Taxpayer initiated disputes

Current international tax BEPS-related proposals will increase uncertainty, and we anticipate an increase in the number of taxpayer initiated disputes. Taxpayers will be required to issue a Notice of Proposed Adjustment ("NOPA") within the four month response period in section 89AB of the TAA, even when the subject matter of the dispute would better be resolved under the MAP.

We submit the response period in section 89AB of the TAA should either be extended or suspended when the taxpayer requests the Commissioner to invoke MAP. This change would provide sufficient time for MAP to be completed without the taxpayer incurring compliance costs in commencing a (possibly unnecessary) domestic dispute, or forfeiting the right to subsequently commence that dispute if it remains unsatisfied by the outcome of MAP.

MAP could alternatively/additionally be treated as an alternative to the domestic disputes procedure. This change would require an amendment to section 138B of the TAA to permit taxpayers to commence a challenge under Part 8A of the TAA if they have completed either:

- ▶ The domestic disputes procedure in Part 4A of the TAA, or
- ▶ MAP.

In that event, presumably the Commissioner would be required to issue a "challenge notice" to a taxpayer who had initiated MAP and remained dissatisfied with the outcome.

In the event the taxpayer also commenced a domestic dispute within the existing response period, the existing four year time limit for resolving that dispute under section 89P of the TAA will have to be suspended, as it would be difficult for the parties to have completed both MAP and then the domestic disputes procedure.

Commissioner initiated disputes

Where the Commissioner has commenced a dispute, consideration needs to be given as to:

- ▶ Whether the parties will be required to complete that dispute pursuant to s 89N of the TAA, if the dispute is also subject to MAP, or
- ▶ Will the resolution of MAP permit the Commissioner to truncate the domestic dispute?

In any of those scenarios under which the domestic disputes procedure is not completed because the MAP has been invoked, consideration will need to be given as to how the exclusion rule in section 138G of the TAA will apply to the subsequent challenge.

Deferred tax

In our view, section 138I of the TAA should be extended to all disputed tax (regardless of which party commences the dispute) where the disputed tax is the subject of MAP. There is an inconsistency in the treatment of "deferred tax" under s 138I of the TAA. That provision suspends the taxpayer's obligation to pay disputed tax until the challenge under Part 8A of the TAA is finally resolved. However, there is no comparable provision within Part 4A of the TAA suspending the obligation to pay disputed tax until the dispute (or subsequent challenge) is resolved. Where the dispute is commenced by the Commissioner, this omission has no practical effect. However, where the dispute is commenced by the taxpayer (whether by proposing an adjustment to its own conservative return or in response to an assessment issued by the Commissioner in reliance on s 89C of the TAA) the disputed tax is immediately payable.

Request to opt-out

An inherent problem with the domestic disputes procedure is the practical inability to resolve disputed facts. MAP suffers from the same failing, with other jurisdictions often having poorer fact finding processes than New Zealand. Neither MAP nor the domestic disputes will resolve a dispute involving questions of both international tax law and contested facts. Some disputes are more efficiently resolved before the courts. Accordingly, in our view, the taxpayer right to request to opt-out of the disputes procedure should be extended to include international disputes.

Interaction between "treaty abuse" under the MLI and "tax avoidance" under section BG 1 of the ITA

We submit that Inland Revenue should provide guidance on the interaction between "treaty abuse" under the MLI and "tax avoidance" / the general anti-avoidance rule ("GAAR") under section BG 1.

The MLI incorporates treaty abuse into New Zealand's DTAs, with New Zealand favouring a "principal purpose test" ("PPT") as our preferred means of meeting the minimum standard. There have also been recent amendments to section BH 1, which grants supremacy to section BG 1 over the application of DTAs.

It is not clear whether a dispute must first be resolved under section BG 1 (which, if applicable, determines the facts to which the DTA and MAP is applied) before MAP can be invoked. If not, then the basis on which the Commissioner seeks to apply MAP to the (presumably still disputed) reconstructed facts is unclear. As the Commissioner cannot unilaterally conduct MAP with the counterparty on the basis of reconstructed facts which remain in dispute, the MAP procedure can presumably either:

- ▶ Be conducted on the taxpayer's original facts (regardless of the Commissioner's allegation of avoidance) applying the PPT test, or
- ▶ Must be invoked only after the domestic dispute over section BG 1 is resolved (which given the recent amendments to section BG 1 results in the PPT test having little, if any, practical effect).

It is not clear how the different thresholds for PPT and section BG 1 co-exist. Treaty abuse arises when a principal purpose was to secure the benefits of the treaty. By comparison, domestic tax avoidance arises when the taxpayer's purpose or effect is more than merely incidental (being the statutory test) and the tax outcomes are not in accordance with the Parliamentary contemplation test (as outlined in *Ben Nevis*)¹.

¹ *Ben Nevis Forestry Ventures Ltd v C of IR (2009) 24 NZTC 23,188*

Although the IP states that the PPT is very similar to the domestic GAAR, the thresholds are different and there is a possibility that a taxpayer may have breached section BG1 but not guilty of treaty abuse (much as some taxpayers have been found liable for tax avoidance under section BG 1 but faced no shortfall penalty for adopting an abusive tax position under section 141D of the TAA – see for instance see *Penny & Hooper v CIR*² and *Glenharrow Holdings Ltd*³). Given the recent amendments to section BH 1, further consideration needs to be given as to whether the treaty abuse provision in the MLI is redundant.

Resourcing issues

Inland Revenue may need to increase the level of resources available to competent authorities in respect of MAP cases.

Implementation of the MLI is likely to result in an increased number of DTA disputes, and we have concerns that Inland Revenue may not have sufficient resources to deal with the increased number of disputes. Consideration should therefore be given the Inland Revenue's resourcing in this area.

Exclusion in the case of renegotiation

We submit that DTAs currently being renegotiated should be included as CTAs.

The IP states that New Zealand's general approach is to include the majority of its DTAs as CTAs. However, DTAs will be omitted where we are currently renegotiating the DTA and the other party agrees that it should not be covered because the provisions are expected to be included in the new DTA.

Given New Zealand's intent to adopt almost all provisions of the MLI across our treaty network, we assume they will represent the Government's model treaty position. Treaty negotiations can be protracted. We see no reason why DTAs currently under renegotiation should not be included as CTAs. While the renegotiated DTA will eventually override the previous DTA (as modified by the MLI), if it is expected that the provisions of the MLI will be included in the new DTA then CTA status will promote greater certainty at an earlier date. It may also allow for smoother ratification of a renegotiated treaty given that there will be fewer policy changes for Parliament to consider.

Consolidated DTA texts

We submit that Inland Revenue should consider producing consolidated DTA texts rather than requiring taxpayers to undertake a comparison with amending protocols or rely on consolidated versions produced by commercial publishers.

The IP states that the Government will not produce consolidated versions of each DTA that has been modified by the MLI (paragraph 4.18). While this approach is consistent with existing practice for amending protocols, reading a DTA that is subject to the MLI is likely to be more difficult than reading a DTA subject to an amending protocol. The IP itself notes that the MLI is of a novel nature (paragraph 1.17).

Accordingly, we believe that production of consolidated DTAs would reduce both uncertainty and compliance costs for taxpayers. While commercial publishers are likely to produce consolidated versions, we believe the significance of the MLI warrants production of authoritative consolidated versions by the Government as opposed to reliance on versions produced by others. We anticipate production will have only a marginal cost to the Government as it will already have analysed the effect of the MLI in deciding on CTA status for each treaty partner.

Effect on outbound investors

We submit that consideration needs to be given to the effect the MLI will have on New Zealand outbound investors.

² Penny and Hooper v Commissioner of Inland Revenue (2011) 25 NZTC 24,396 (SC)

³ Glenharrow Holdings Ltd v Commissioner of Inland Revenue (2009) 24 NZTC 23,236 (SC)

Most of the attention around the effect of the MLI has been focused on inbound investors. We believe it is necessary to consider the impact of entering into CTAs on New Zealand outbound investors, in particular, the provisions regarding third-state permanent establishment rules and rules regarding the artificial avoidance of permanent establishment status.

New Zealand already has robust source taxation rules, strong anti-avoidance law and a comprehensive treaty network. Further changes to our domestic law regarding permanent establishments are proposed. This combination of factors means the New Zealand Government may raise relatively little revenue from inbound investors as a result of the MLI.

Outbound New Zealand investors, however, may face bigger effects. Where investment is into jurisdictions with a lesser degree of focus on permanent establishment or sourcing rules, the effect of the MLI may be to increase the taxing rights of our treaty partners, to the detriment of both outbound investors and the Government.

Anti-Abuse Rule for Permanent Establishments situated in third jurisdictions

We submit that greater explanation is required for New Zealand's decision to adopt Article 10 of the MLI regarding third-state permanent establishment rules.

Australia does not intend to adopt Article 10 pending further analysis of its potential impact in the Australian context.⁴ We are not clear on the article's impact in New Zealand and would welcome greater explanation of New Zealand's position and/or an approach comparable to that of Australia.

⁴ Australia's adoption of the BEPS Convention (Multilateral Instrument), Australian Government Consultation Paper, December 2016