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

7 April 2017

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New Zealand's implementation of the Multilateral Convention to Implement Tax Treat 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.

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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,

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Senior Tax Advocate

Professor Craig Elliffe
Tax Advisory Group

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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).

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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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Substantive BEPS provisions in the multilateral instrument

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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)	**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. *Article 3 of the MLI*	No	Yes	See our submission
	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. *Article 4 of the MLI*	No	Yes	See our Submission
	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. *Article 5 of the MLI*	No	Not applicable	Yes
2. Preventing the granting of treaty benefits in inappropriate circumstances (Action 6 report)	**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. *Article 6(1) and (2) of the MLI*	Yes	Yes	Yes
	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,"	No	Yes	Yes

BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
	Article 6(3) and (6) of the MLI			
	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.	Yes	Yes	Yes
	Article 7 of the MLI			
	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.	No	Yes	Yes
	Article 8 of the MLI			
	Land rich company rules 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.	No	Yes	Yes

BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
	The MLI provision also ensures the same rule applies to other investment vehicles such as partnerships and trusts. *Article 9 of the MLI*			
	Third-state PE rules 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. *Article 10 of the MLI*	No	Yes	Yes
	Right to tax own residents 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). *Article 11 of the MLI*	No	Yes	Yes
3. Preventing the artificial avoidance of PE status	**Commissionaire arrangements and similar strategies** 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. *Articles 12 and 15 of the MLI*	No	Yes	Yes
	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 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	No	Yes	Yes

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. *Articles 13 and 15 of the MLI*			
	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. *Articles 13 and 15 of the MLI*	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. *Articles 14 and 15 of the MLI*	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 *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). *Article 16 of the MLI*	Yes	Yes	See our submission
	MAP – corresponding adjustment Requires contracting states to make appropriate corresponding adjustments in transfer pricing cases. *Article 17 of the MLI*	No	Yes	

BEPS measure	Detail	Minimum standard	Should NZ adopt?	Agree / disagree
	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. 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. 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)). 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. *Articles 18 – 26 of the MLI*	No	Yes	See our submission