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Deputy Commissioner, Policy and Strategy
Inland Revenue Department
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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".

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.)

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. his 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:

- PIEs 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.

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

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Yours sincerely

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