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TP EQuilibrium | AustralAsia LP

A Duff & Phelps Transfer Pricing Alliance Partner

To: Deputy Commissioner of Taxation, Policy and Strategy, New Zealand Inland Revenue

From: Leslie Prescott-Haar, Stefan Sunde / TP EQuilibrium | AustralAsia LP

Subject: BEPS – Transfer Pricing and PE Avoidance

Date: 18 April 2017

TP EQuilibrium | AustralAsia ("TPEQ") has prepared this submission in respect of the New Zealand Government's discussion document, *BEPS – Transfer Pricing and PE Avoidance*, published in March 2017.

TPEQ has prepared these comments on the discussion document specifically, and selectively, from a transfer pricing perspective. Our comments are based on our transfer pricing experience with Australian and New Zealand transfer pricing matters. In this regard, we have limited our comments to certain proposals contained in Chapters 5 and 6 of the discussion document. As such, TPEQ has not commented on all aspects of the various proposals. Our comments with respect to Chapter 5 are substantive, whereas our comments with respect to Chapter 6 are practical.

We are comfortable discussing these points raised further with the Inland Revenue or Treasury officials, as may be requested.

The submission is generally structured in alignment with the structure of the discussion document, unless otherwise indicated.

Overall 'General' Comments

Whilst we welcome alignment with the most current OECD guidance, and we recognise the importance of trans-Tasman trade flows, we caution against a desire for alignment with Australia's transfer pricing rules, simply for the sake of alignment.

Australia's revised transfer pricing regime is exceptionally burdensome, excessive in terms of compliance costs, over-steps the OECD Guidelines in various respects, will likely result in a materially increased number of disputes, and remains unchallenged in the Australian courts. Therefore, we urge caution against interpreting that legislation as "a good way" to challenge situations where legal form does not match economic substance.

Moreover, the discussion document appears to misinterpret Section 815-130 of Australia's revised transfer pricing regime as a reconstruction provision, rather than a provision to identify the arm's length conditions of a transaction.

Proposals to consider reconstruction of transactions are unduly aggressive, and such should be avoided unless in exceptional circumstances

The proposals contained in the discussion document relating to the reconstruction of a transaction where its form does not align with the economic substance must be considered carefully. In particular, Para. 5.39 notes that, under the proposals, New Zealand's rules would not restrict reconstruction to only "exceptional circumstances". We also note that, contrary to the OECD Guidelines, there appears to be an intent (para. 5.29) to target transactions only rarely occurring between third parties. Per the revised OECD Guidelines[1]:

> *The key question in the analysis is whether the actual transaction possesses the commercial rationality of arrangements that would be agreed between unrelated parties under comparable economic circumstances, not whether the same transaction can be observed between independent parties. The* ***non-recognition of a transaction that possesses the commercial rationality of an arm's length arrangement is not an appropriate application of the arm's length principle****. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured. It should again be noted that the mere fact that the transaction may not be seen between independent parties does not mean that it does not have characteristics of an arm's length arrangement.*
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> *The structure that for transfer pricing purposes, replaces that actually adopted by the taxpayers should comport as closely as possible with the facts of the actual transaction undertaken whilst achieving a commercially rational expected result that would have enabled the parties to come to a price acceptable to both of them at the time the arrangement was entered into.*

Any New Zealand legislative and/or IRD approach which is inconsistent with the OECD guidance would be unsatisfactory in New Zealand's transfer pricing framework, having regard to the evidential burden placed upon multinationals to disprove hypothetical reconstructions; this would result in excessive compliance costs for operations that are insignificant (for most multinationals); and would likely materially increase in the number of disputes, Competent

[1] Final OECD BEPS Reports – Actions 8-10, paras. 1.123 – 1.124.

Authority cases, and instances of economic double taxation. In this regard, the New Zealand avoidance regime and case law are already highly effective deterrents against aggressive taxation arrangements, as the Commissioner already has broad discretion to reconstruct tax avoidance arrangements appropriately, and adequately address such ‘problematic’ structures. Given the effective workings of New Zealand’s anti-avoidance regime, it is not necessary for New Zealand to introduce separate reconstruction provisions within the transfer pricing rules. As such, it is inappropriate for the Inland Revenue to “re-write” the terms and conditions of multinational transactions for a variety of reasons, except in exceptional avoidance circumstances. Instead, a provision making reference to the OECD Guidelines, as the most current internationally accepted guidance, would appear to suffice with regards to alignment of substance with legal form.

Per Para. 5.29, we caution against ‘risk shifting’ as an indicator for any recharacterisation. We note that, for example, there is limited rationale to establish a low-risk distributor, other than to create a stable, low-risk entity, which for a multinational reflects a commercial arrangement that may simply not be available to independent parties. The limited risk distributor approach is a common and well accepted inbound and outbound structure which minimises transfer pricing risk for the distributor and its group, including by the Inland Revenue in APAs. Conversely, the financial results of full risk marketer-distributors are often highly variable (as a result of market/economic conditions, currency exchange rates, etc.) and such variability of distribution profitability inevitably attracts the scrutiny of revenue authorities around the world. This is only one example of various possible structures that apportion risk in a particular way, with sound commercial basis, but do not indicate aggressive profit shifting.

Further, risks are contractually transferred globally every day in uncontrolled transactions. Hence, risk shifting should not be a primary factor considered as part of a potential recharacterisation. We note that section 815-130 of Australia’s Income Tax Assessment Act 1997 does not address risk in such a granular fashion.

Further to the above, the nature of the New Zealand dollar as a ‘commodity’ currency, making NZS exchange rates typically more volatile, provides further justification for limited risk approaches in respect of controlled transactions with New Zealand, to improve stability, certainty and long term profitability of New Zealand businesses.

Administrative Measures

The comments below are based on TPEQ’s practical audit experience.

In our experience, audit delays are typically not attributable to taxpayer non-cooperation. In this regard, multinationals would [almost always] prefer to respond to audit queries and resolve audits as quickly as reasonably possible, with a view to progressing the matter to its final conclusion, achieving certainty over the outcome at the earliest opportunity. Audit issues experienced by the Inland Revenue may, to a large extent, reflect requests for information that simply does not exist within multinationals, or is not prepared in the normal course of business management and / or decision-making. It is inevitable that there would be some delay in providing such information, as it may take considerable time to collate or prepare, this having to be balanced with other commercial imperatives. The necessity for broad administrative legislative changes is therefore lacking.

Instead, we believe a flexible process facilitating ‘open discussions’ with the Inland Revenue relating to their audit information requests would be more effective and should be implemented, to balance the Inland Revenue’s information needs with multinationals’ compliance costs. Per the general USA IRS procedures, information requests are initially provided to taxpayers in draft form, providing an opportunity to discuss the nature and extent of the information requested as compared to what is available, and tailor the request to the specific circumstances and risk profile of the taxpayer.

On Para. 5.71, should the 7-year statute bar for transfer pricing assessments become law, then the Inland Revenue should, as a practical matter, become more open to longer term APAs.

We note the intent that the proposed measures would leave co-operative multinationals largely unaffected (para 6.13), but we have concerns in practice that this would not be the case. We also note the intention to implement internal review processes to ensure such measures could not be applied lightly (para. 6.18), but the discussion paper remains vague on what would be considered “reasonable in the circumstances” (para. 6.17).

On Para 6.19, for non-cooperative major multinationals, it could presumably be evidentially unfavourable for the Inland Revenue to issue NOPAs that are based on incomplete evidence and / or insufficient analysis, as well as being procedurally inefficient for both the Inland Revenue and multinationals. Whilst we understand the Inland Revenue’s need to address the minority of taxpayers that are non-compliant, we believe that the existing provisions represent an adequate and effective arsenal available to the Commissioner.

On Para 6.26, it is unfair to penalise all multinationals for the sins of a few, by requiring all taxpayers to make upfront ‘pay to play’ tax payments based on insufficiently evidenced NOPAs. Also, limiting repayment of disputed tax only in the event of a successful court challenge (para. 6.25) excludes the possibility of other dispute resolution mechanisms. Payment of disputed tax should be made upon resolution of the matter by any means.

Para 6.35 appears quite draconian and punitive, as a New Zealand person could potentially be convicted for the directions and/or actions of others, or alternatively, in connection with an information request covering information that does not actually exist. In relation to the latter point, the proposed approach does not recognise that, even where the relevant person is willing to co-operate, it may be difficult for them to prove that the requested information simply does not exist.