26 April 2017

BEPS – Transfer pricing and PE avoidance
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Sir/Madam

Submission on Discussion Document: BEPS – Transfer pricing and permanent establishment avoidance

The following submission has been prepared by AMP Capital Investors (New Zealand) Limited (AMP Capital New Zealand) on the Discussion Document: BEPS – Transfer pricing and permanent establishment avoidance. AMP Capital New Zealand is a specialist investment manager that manages a number of funds that are Portfolio Investment Entities (PIEs), as well as private equity investments.

Our submission focuses on the potential affect of the transfer pricing proposals contained in the discussion document on some of the investments that we manage on behalf of investors. We are not commenting on the permanent establishment proposals. However, this does not mean that we necessarily endorse the comments and outcomes reached by the Commissioner in the discussion document on permanent establishment.

Background

New Zealand has a broad base, low rate tax system with limited exceptions. We understand what you are trying to achieve which is ensuring that if economic activity occurs here that New Zealand collects tax. Thus where non-residents are carrying on business in New Zealand they should bear their share of tax. However, some of the proposals seem to go too far and will affect the majority of multinationals that you state operate in New Zealand and are tax compliant[1]. Our comments on the specific transfer pricing proposals set out in the discussion document are detailed below.

Economic substance

The proposal for transfer pricing practices to align with economic substance[2] moves New Zealand to a "would have test". Under the economic substance test taxpayers may have issues with obtaining relevant external facts that match for comparison to their circumstances. This is applicable to specific industries and distinctive fact taxpayers. This issue needs to be considered and workable solution found.

There also needs to be consideration on how Inland Revenue Officials will use and apply the economic substance test in the future. Views may shift over time which could result in detrimental effects on taxpayers. This could result in Inland Revenue with the benefit of hindsight assessing taxpayers based on better level of information than what was available at the original time. Safeguards need to built into any rules that introduce the economic substance test, to ensure that views or interpretation do not shift over time.

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[1] Page 2, point 1.8, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance
[2] Pages 29-30, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance

AMPCAPITAL.CO.NZ
T +64 4 494 2200 F +64 4 494 2123 Ground Floor, 113 – 119 The Terrace, Wellington 6011 PO Box 3764, Wellington 6140 New Zealand
AMP Capital Investors (New Zealand) Limited

Reconstruction of transactions

The proposed transfer pricing reconstruction rules[3] comments that these rules will reduce certainty for taxpayers but this should only be in the case where the arrangement is aggressive and commercially irrational. There is no explanation on what would or could be considered arrangements that are aggressive and commercially irrational for the proposed reconstruction rules to apply. Further there are no details on what measures or how one measures aggressive and commercially irrational arrangements.

We are concerned that test for an arrangement being aggressive and commercially irrational appears subjective and dependant on Inland Revenue Officials. Further, we note the issue of Inland Revenue Officials understanding, awareness and comprehensive of commercial environments, specific industries and the structures in which different businesses operate. For example a lack of familiarity with the commercial and legal implications of managed funds. There need to be safety measures in any rules introduced to ensure that a lack of commercial comprehensive and familiarity does not trigger the application of the reconstruction rules to a taxpayer. Applying an exceptional circumstances test like Australia has to the application of the reconstruction rules, may assist with this.

If any reconstruction rules are introduced there needs to be clear legislation and guidance for both taxpayers and Inland Revenue Officials on:

- what is meant by arrangements that are aggressive and commercially irrational,
- what is measured and how it is tested, and
- Inland Revenue sign-off i.e. Deputy Commissioner to apply the reconstruction rules to a taxpayer.

Arms length conditions

It is proposed that the transfer pricing rules are changed to refer to arms length conditions. This would require taxpayers to take into account the relevant conditions that a third party would be willing to accept when determining an arm's length price[4]. The proposals do not consider the situations of there being no equivalent third party comparisons or data for a taxpayer to use and very limited publically available data. Further there are situations where associated cross-border entities may accept a lessor commercial deal in order to give a better overall outcome for the group e.g. keep a client. How would the types of situations outlined be considered by Inland Revenue? In particular, would Inland Revenue consider each scenario for group member in isolation or can or will the bigger commercial picture of the outcome for a group of entities be taken into consideration?

Burden of proof

It is proposed that the burden of proof for transfer pricing should be shifted to taxpayers, due to taxpayers being far more likely to hold the relevant information to support its pricing than the Inland Revenue or other parties[5]. If this proposal is adopted, then Inland Revenue Officials will need to:

- factor in their own preconceptions, biases and assumptions when taxpayers provide their facts, and
- be prepared to obtain from taxpayers an awareness and familiarity of commercial environments, industries and specialised taxpayer circumstances, and
- be aware of constraints that apply to taxpayer's and the implications of these restrictions. For example trustees or supervisors roles in managed funds.

There should be some sort of protection included into the updated transfer pricing rules that preserves presented or stated taxpayer's facts unless exceptional circumstances apply such as the application of the reconstruction rules.

Time bar

We question the need to extend the time bar on transfer pricing matters from the current four years to seven years given the Inland Revenue will have real time data from its international questionnaires and

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[3] Pages 30-31, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance
[4] Pages 31-32, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance
[5] Pages 32-33, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance

transformation project. If there are issues resolving transfer pricing reviews surely it is more appropriate for Inland Revenue to buy in or hire more resources just like commercial operators are required to do, rather than changing the rules. Further obtaining resources with commercial and specific industry experiences could assist Inland Revenue. For completeness, we have experienced significant delays (over a year) in obtaining transfer pricing responses from Inland Revenue Officials. Thus not all delays in this area are taxpayer based and therefore any timing requirements should apply to both Inland Revenue and taxpayers.

There is no transition period mentioned in the extension of time bar proposals, the result of this means that periods that are currently statute barring will be reopened for transfer pricing purposes on application of this rule. This will create uncertainty for businesses as they have already assumed that particular years are statute barred. Further this would allow Inland Revenue the benefit of hindsight through applying the amended transfer pricing rules rather than using current transfer pricing rules for a further additional three years.

Master and local files

It is stated that master and local file transfer pricing documents are to be provided upon a request or audit[6]. There is no commentary about the reasoning's behind a request and the form a request should take. To ensure that there is no change in view from Inland Revenue in the future, it would be appropriate to codify the circumstances in which such a request for master and local files can be made and the form of that request.

Investors acting in concert

There are limited details on how investors will be determined to be "acting in concert" for transfer pricing purposes and in what way this proposal may work. There are no comments on whether other jurisdictions will be applying similar rules; is New Zealand out of step with the rest of the world? New Zealand is a capital importing country thus we need offshore investors for large capital intensive projects and private investments. There will be additional costs for non-resident investors under this proposal through the acquired New Zealand entities being subject to transfer pricing rules and possibly themselves. This is yet another barrier to get non-residents across before they will invest in New Zealand entities or projects.

Prima facie it appears that private equity managers may be pushed into assisting non-resident investors and New Zealand acquired entity's with their transfer pricing obligations in these circumstances. This is not a usual role for a private equity manager. The level of fees charged by private equity managers would need to reflect the time and effort spent on transfer pricing matters.

Non-cooperation

If the proposed rules are introduced about when a taxpayer is being regarded as non-cooperative, they need to clearly define non-cooperation, what is measured and how this is tested. In particular, around any materially misleading information as this appears a subjective test and dependant on points of views which can be different between Inland Revenue and a taxpayer. There needs to be clear guidance, transparent procedures and processes to ensure the application of this type of rule is fair to taxpayers and not subject to preconceptions, biases and assumptions.

Any rules introduced need to contain appropriate timeframes that apply to both the multinationals and the Inland Revenue. The Inland Revenues standard of four weeks to six weeks for businesses replying to their requests for information needs to be extended, to account for peaks in work flow.

Payment of tax in dispute

The proposal for tax to be paid earlier in a dispute by multinationals is justified by the statement that collection of tax can be delayed for several years and this provides an incentive for multinationals to prolong disputes. However, as previously noted Inland Revenue has delayed responding to taxpayers and in these circumstances this would unfairly penalise taxpayers. There is a cost to having funds tied up. If Inland Revenue are holding on to large amounts of disputed tax they should pay the market rate for the opportunity cost of taxpayers having to fund these amounts. Further, checks and balances would need to be put in place to ensure that any assessment of whichever disputed tax issued to a taxpayer has a solid basis behind it.

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[6] Page 34, point 5.58, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance

No reasoning's have been provided to back up the statement that purchases from a tax pooling service would not be acceptable as the payment of tax[7]. What is the justification for why this type of payment should be excluded?

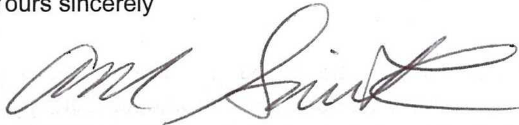
Collection of Information

The fact that the Inland Revenue is having issues with obtaining information about offshore multinational group members of taxpayers from other tax authorities should not be a reason for changing the powers of the Commissioner in this area. Instead Inland Revenue Officials should put effort into their working relationships with other tax authorities to ensure that they obtain the information or assistance they want. Further, this proposal would push information collection onto New Zealand taxpayers of multinational groups as "information would first be passed on to the relevant New Zealand taxpayer who would then supply this information to Inland Revenue"[8]. There is a cost impact for taxpayers under this proposal.

Inland Revenue seems to be propositioning taking on an international policing role under this proposal, is this appropriate?

Please feel free to contact the writer on 9(2)(a) if you would like to discuss any of the points outlined above.

Yours sincerely



Adele Smith
Head of Tax
T 9(2)(a)
E adele.smith@ampcapital.co.nz

[7] Page 43, point 6.24, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance
[8] Page 44, point 6.33, Discussion Document BEPS – Transfer pricing and permanent establishment avoidance