



Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

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MINISTERIAL SERVICES UNIT

Tax policy report: Base erosion and profit shifting – overview of current reports

Date:	22 June 2017	Priority:	Medium
Security level:	In Confidence	Report no:	T2017/1578 IR2017/329

Action sought

	Action sought	Deadline
Minister of Finance	Agree to the recommendations	29 June 2017
Minister of Revenue	Agree to the recommendations	29 June 2017

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Kilford	Policy Manager, Inland Revenue	Withheld under section 9(2)(a) of the Official Information Act 1982
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22 June 2017

Minister of Finance
Minister of Revenue

Base erosion and profit shifting – overview of current reports

1. This report accompanies three papers providing further updates on the development of policy proposals introduced in three Government discussion documents on base erosion and profit shifting (BEPS):

- *Addressing hybrid mismatch arrangements* (released in September 2016);
- *BEPS – Strengthening our interest limitation rules* (released in March 2017); and
- *BEPS – Transfer pricing and permanent establishment avoidance* (released in March 2017).

2. We reported to you on 9 March 2017 with a summary of submissions received on the discussion document *Addressing hybrid mismatch arrangements* (T2017/460, IR2017/133 refers). We also reported to you last week with a summary of submissions on the two March 2017 discussion documents (T2017/1630, IR2017/361 refers).

3. This package of reports seeks policy decisions on a range of proposals relating to all three discussion documents, including a number of suggested refinements to address issues raised by submitters. The attached reports are:

- BEPS – interest limitation submissions and policy decisions (T2017/1576, IR2017/325);
- BEPS – transfer pricing and permanent establishment avoidance submissions and policy decisions (T2017/1577, IR2017/330); and
- BEPS – recommendations on addressing hybrid mismatch arrangements (T2017/1604, IR2017/353).

4. These reports also seek your approval for officials to prepare a set of four papers seeking Cabinet's agreement to policy decisions and to include the BEPS proposals in a tax bill later this year. Subject to your decisions and assuming you are comfortable with all the proposals, we anticipate the following timeline:

Date	Milestone/action
Thursday 29 June	Joint Ministers' meeting to discuss these reports and policy recommendations
Week commencing 10 July	Provide the following Cabinet papers and RISs to Ministers: <ul style="list-style-type: none"> • Cover paper with overview of BEPS package • Transfer pricing and permanent establishment avoidance • Interest limitation • Hybrid mismatches
Thursday 20 July	Deadline for lodging Cabinet Papers in CabNet
Wednesday 26 July	EGI
Monday 31 July	Cabinet

Further consultation

5. We recommend that, following Cabinet decisions in July, further consultation is undertaken on outstanding policy issues and technical design details relating to the BEPS package. We will report back to you on that consultation and any further feedback we receive on the proposals.

6. A number of submitters have also expressed interest in consultation on an exposure draft of the planned BEPS bill. We have signalled to submitters that an exposure draft could be provided on specific aspects of the proposals that are likely to be of most interest – for example, the permanent establishment anti-avoidance rule proposed in the discussion document *BEPS – Transfer pricing and permanent establishment avoidance*.

7. To stay on track with the planned commencement date of income years starting on or after 1 July 2018, the BEPS bill will need to be introduced and have its first reading by 14 December 2017. Due to this timing constraint, we are not proposing that submitters be consulted on an exposure draft of the entire bill. However, targeted drafting of specific sections where consultation will provide the most value is possible within this timeframe.

8. In the attached reports on interest limitation, and transfer pricing and permanent establishment avoidance, we have focused on the major issues relevant to the policy decisions to be made by Cabinet in July. We have not addressed all submissions on the March 2017 discussion documents that relate to technical or operational detail. We will advise you on such submissions following detailed design and further consultation with submitters. The hybrids report seeks more detailed final policy decisions because it has already been subject to a second round of consultation.

Fiscal implications

9. Some of the revenue for these proposals has already been included in Budget 2017 forecasts:

\$ million – increase / (decrease)							
Vote Revenue	2016	2017	2018	2019	2020	2021	2022/23
	/17	/18	/19	/20	/21	/22	and out
							years
Foreign hybrid entity double deductions	0	0	25	50	50	50	50
Other BEPS measures	0	0	25	50	50	50	50
Total revenue effect	0	0	50	100	100	100	100

10. If our recommendations in these four reports are agreed to and adopted by the Government, then the forecasts could be adjusted further by these amounts:

\$ million – increase / (decrease)							
Vote Revenue	2016	2017	2018	2019	2020	2021	2022/23
	/17	/18	/19	/20	/21	/22	and out
							years
BEPS measures – transfer pricing, permanent establishments, and interest limitation	0	0	45	90	90	90	90
BEPS measures – hybrid instruments	0	0	19	19	19	14	0
Total additional revenue effect	0	0	64	109	109	104	90

11. The additional revenue from certain hybrid instruments is a result of agreeing to the OECD hybrids recommendation 1 proposal with the grandparenting approach for these instruments recommended in the attached paper on hybrids. This revenue is contingent on taxpayer behaviour after the implementation of the hybrid rules.

12. The total would come to the maximum revenue forecast for new BEPS measures that we have previously advised (\$190 million per year for out years) and exceed this revenue forecast for the first four years in which the BEPS measures will apply. We are recommending in the report BEPS – interest limitation submissions and policy decisions (T2017/1576, IR2017/325 refers) that we continue to consult on details of the thin capitalisation proposal. Depending on the outcome of this consultation, the revenue forecast could be \$10 million per year lower.

Economic implications

13. It is inevitable that the higher tax payments resulting from these measures will make New Zealand a less attractive investment location for multinationals engaged in BEPS arrangements. At the same time, these multinationals should not be allowed to exploit weaknesses in our tax rules to achieve a competitive advantage over more compliant multinationals or domestic firms. Furthermore, random reductions in tax, depending upon the opportunism of taxpayers, are likely to distort the allocation of investment into New Zealand. Given this, we believe implementing these measures remains in New Zealand's best economic

interests.

Administrative implications

14. The changes proposed in the BEPS discussion documents and recommended in these reports are not expected to increase administrative costs or require any significant systems changes for Inland Revenue. This is because the reforms change the way some taxpayers self-assess their tax liabilities that they report to Inland Revenue.

15. We note, however, that a common theme in submissions on all three discussion documents was that administration of the proposals would place a higher demand on Inland Revenue's audit and investigation functions. Our view is that any required increase in Inland Revenue's resourcing as a result of the BEPS package will be accommodated within existing baselines. We will report back if these administrative implications are expected to change.

Application date

16. Cabinet has noted that the reforms are expected to commence from income years beginning on or after 1 July 2018 (CAB-17-MIN-0164 refers). This is based on an expectation that the legislation will be progressed to enactment before this date.

17. At the time the March 2017 discussion documents were released, this application date was not publicly known. However, many submitters anticipated the Government would seek an early application date and argued in their submissions that there needs to be sufficient lead-in time for these proposals to allow taxpayers to restructure their affairs if necessary. We expect to receive more feedback on the planned application date and other transitional issues in the next round of consultation.

Proactive release

18. We recommend that the Government consider proactively releasing submissions on the BEPS discussion documents and the MLI officials' issues paper, the BEPS Cabinet papers, and policy reports (including the pre-Budget 2017 Cabinet paper and policy report (T2017/949, IR2017/237)). This could be done at the time of announcements Ministers may want to make in relation to the package.

Recommended action

We recommend that you:

- (a) **Note** the three reports attached.

Noted

Noted

- (b) **Agree** that work progresses along the indicative timeline.

Agreed / Not Agreed

Agreed / Not Agreed

- (c) **Agree** that the BEPS Cabinet paper should recommend that officials undertake further consultation on outstanding policy issues, technical design details and an exposure draft of selected items for the planned BEPS bill, with a view to introducing the bill after the General Election.

Agreed / Not Agreed

Agreed / Not Agreed

- (d) **Agree** to proactively release the BEPS Cabinet papers, policy reports and submissions on consultation documents.

Agreed / Not Agreed

Agreed / Not Agreed

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