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A special report from
Policy and Strategy, Inland Revenue

Base erosion and profit shifting – administrative measures

Introduction

This is the final version of the special report on administrative measures for base erosion and profit shifting (BEPS).

The rules were enacted on 27 June 2018 in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

This special report was also published in the April 2019 edition of the *Tax Information Bulletin* (Volume 31 Number 3).

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DEFINITION OF LARGE MULTINATIONAL GROUP

Section YA 1

The new legislation introduces the term “large multinational group”, which is relevant as Inland Revenue’s increased powers to assess tax or collect information only apply to members of large multinational groups.

Background

The rules in the new legislation that increase Inland Revenue’s powers to assess tax or collect information are limited so they only apply to members of large multinational groups. These rules are:

- The permanent establishment anti-avoidance rule in new section GB 54 of the Income Tax Act 2007 which can only be applied to members of large multinational groups.
- New section HD 30 which allows the Commissioner of Inland Revenue to collect tax that is owed by a non-resident member of a large multinational group from a wholly-owned group member who is a New Zealand resident or that has a permanent establishment in New Zealand.
- New section 17(1CB) of the Tax Administration Act 1994 extends the Commissioner of Inland Revenue’s powers to request information so they also apply to information or documents relevant to the taxation of the large multinational group and that is held by any member of that large multinational group, including group members who are outside New Zealand.
- New section 21BA of the Tax Administration Act 1994 can be used to apply consequences to a member of a large multinational group that fails to provide an adequate response to a section 17 request for information or documents within a reasonable timeframe. These consequences enable the Commissioner of Inland Revenue to make a tax assessment based on the information she has available and to prevent information that was requested, but not provided to the Commissioner, from being admitted as evidence in a dispute or court proceeding.
- New section 139AB of the Tax Administration Act 1994 provides the ability for the Commissioner of Inland Revenue to apply a civil penalty of up to \$100,000 on a member of a large multinational group that does not co-operate with requests for information.
- Large multinational groups whose ultimate owner is a New Zealand resident parent entity are required to file a country-by-country report with Inland Revenue under new section 78G of the Tax Administration Act 1994.

Key features

A large multinational group is defined in section YA 1 as a consolidated accounting group that has annual consolidated group revenue for the preceding income year or period prior to the relevant income year of more than EUR €750m (which is the exemption threshold described in paragraph 5.52 of the OECD Transfer Pricing Guidelines).

This EUR €750m revenue threshold was agreed by the OECD as a way to define the large multinational groups that are required to file Country-by-Country reports with relevant tax authorities.

Example

M is a multinational group which has a member which is resident in New Zealand. M's consolidated accounts reported revenues of US \$1.8b for the year ending 31 December 2018. Because these revenues are more than EUR €750m on 31 December 2018, for M's next income year beginning 1 January 2019, M will satisfy the definition of a large multinational group.

To qualify as a large multinational group, the group must also have a member resident in New Zealand or income with a source in New Zealand and a member who is resident in a country or territory other than New Zealand.

There is no requirement that the group members be companies, so the revenues for consolidated group could include revenues that are earned through partnerships or trusts.

REQUESTING INFORMATION FROM LARGE MULTINATIONAL GROUPS

Sections 17(1CB), 21BA, 139AB and 142GB of the Tax Administration Act 1994

The new legislation amends the Tax Administration Act 1994 to provide the Commissioner of Inland Revenue with additional powers to request information from large multinational groups in order to assist a tax investigation of the relevant multinational.

Background

To combat BEPS, Inland Revenue needs to be able to properly investigate complex tax positions taken by multinationals. One of the main practical difficulties that Inland Revenue has encountered in conducting these investigations is a lack of willingness by some multinationals to provide information.

The information required in an investigation can include legal contracts and evidence about commercial and economic activities carried on by offshore entities. This information is often held by an offshore group member of the multinational, rather than in a New Zealand company or office. For example, it is common for multinationals to prepare and retain transfer pricing documentation within a specialist transfer pricing unit in their head office in another jurisdiction.

As the OECD notes in paragraph 5.15 of chapter V of their Transfer Pricing Guidelines:

“It may often be the case that the documents and other information required for a transfer pricing audit will be in the possession of members of the MNE group other than the local affiliate under examination. Often the necessary documents will be located outside the country whose tax administration is conducting the audit. It is therefore important that the tax administration is able to obtain directly or through information sharing, such as exchange of information mechanisms, information that extends beyond the country’s borders.”

In addition to transfer pricing, Inland Revenue needs to access offshore information to apply other international tax rules. These include the permanent establishment rules which determine whether New Zealand can tax the business profits of a non-resident company (and if so, how much of that profit New Zealand can tax), and the general anti-avoidance rule, which may be used to challenge cross-border tax avoidance.

Key features

The new rules in relation to requesting information only apply to members of large multinational groups. A large multinational group is defined in section YA 1 as a consolidated accounting group that has annual consolidated group revenue exceeding EUR €750m for the preceding income year or period prior to the relevant income year. The group must also have a member resident in New Zealand or income with a source in New Zealand and a member who is resident in a country or territory other than New Zealand.

The Commissioner of Inland Revenue has a power under section 17 of the Tax Administration Act 1994 to request specific information or documents from a person as part of a tax

investigation. This person would typically be resident of New Zealand or have a physical presence such as an office in New Zealand.

New section 17(1CB) expands the scope of the existing section 17 power by allowing it to also be used to request information or documents that are held by any member of a large multinational group. This includes members that are non-residents, such as a parent or a sister company.

The information must be relevant to the taxation of the large multinational group, as opposed to an investigation concerning the tax position of someone who is outside the group such as a customer. For multinational tax investigations the relevant information sought will typically be about companies rather than natural persons.

In some cases customer information may be relevant to the taxation of the large multinational group. For example a contract with a customer may be relevant to applying the transfer pricing rules to determine whether a related party arrangement has arm's length conditions and an arm's length amount of consideration.

New section 21BA is designed to bolster Inland Revenue's ability to require multinationals to comply with a request for information under section 17 by setting out some specific consequences that can be applied if the multinational fails to provide an adequate response within a reasonable timeframe. These consequences enable the Commissioner to make a tax assessment based on the information she has available and to prevent information that was requested, but not provided to the Commissioner, from being admitted as evidence in a dispute or court proceeding.

New section 139AB provides the ability for Inland Revenue to apply a civil penalty of up to \$100,000 on large multinational groups which do not co-operate with requests for information.

Application date

The amendments to insert new sections 17(1CB), 21BA, 139AB and 142GB into the Tax Administration Act 1994 apply from 27 June 2018, which is the date that the Taxation (Neutralising Base Erosion and Profit Shifting) Act received Royal assent. This means that these new administrative powers and penalties can be used by Inland Revenue after 27 June 2018 when pursuing current or new investigations, even if those investigations include income years prior to the date of enactment.

Detailed analysis

Section 17(1CB): Allowing Inland Revenue to request information held by non-resident members of large multinational groups

New section 17(1CB) allows the Commissioner to apply section 17(1) to request information or documents that are in the knowledge, possession, or control of a member of a large multinational group, including members that are non-resident.

The requested information must be relevant to the taxation of the large multinational group, as opposed to an investigation concerning the tax position of someone who is outside the group

such as a customer. For multinational tax investigations the relevant information sought will typically be about companies rather than natural persons.

In some cases customer information may be relevant to the taxation of the large multinational group. For example a contract with a customer may be relevant to applying the transfer pricing rules to determine whether a related party arrangement has arm's length conditions and an arm's length amount of consideration.

Although section 17(1CB) can be used to request information from any member of the large multinational group, in practice, it is anticipated that the Commissioner would request the information from the group member who is resident or potentially subject to tax in New Zealand. In some cases, that group member may already hold or be able to access (e.g. through a shared internal document system) the information themselves. If the group member does not hold or have access to the information themselves, they will need to source the required information from other members of their group and then pass on the requested information to the Commissioner of Inland Revenue.

For example, the Commissioner could ask a New Zealand subsidiary of a multinational corporation to provide transfer pricing documentation that was held by their offshore parent. The New Zealand subsidiary would ask their parent to provide this documentation to them, and they would then supply it to the Commissioner.

Inland Revenue understands that large multinational groups typically have processes whereby information requests from tax authorities are escalated and approved by their head office (this can include cases where the relevant information is already held in New Zealand). The head office will have the authority to require the other group members to provide the information.

Further information about Inland Revenue's operational procedures for issuing notices under section 17 is available in Operational Statement OS 13/02¹ which outlines the procedures. Although this Operational Statement has not been updated to reflect the new section 17(1CB) the intention of section 17(1CB) is simply to expand the scope of Inland Revenue's existing section 17 power so it also applies to information held by any member of a large multinational group. The existing operational procedures include:

- Where information is to be demanded under section 17, a notice will be issued in writing. Generally a section 17 notice will only be issued following a failure to provide information previously requested or where specific issues have been identified and attempts to resolve these issues have failed.
- The Commissioner will only require disclosure of information considered necessary or relevant and that is reasonably required in the circumstances of the case. The Commissioner will be reasonable in relation to the quantity of information sought and the timeframe for providing that information. Reasonable time will be allowed where there is genuine difficulty in obtaining and/or providing the information requested.

Section 21BA: Consequences from failure to provide information

New section 21BA is designed to bolster Inland Revenue's ability to require multinationals to comply with a request for information under section 17 by setting out some specific consequences that can be applied if the multinational fails to provide an adequate response

¹ <http://www.ird.govt.nz/technical-tax/op-statements/os-1302-sec-17-notices.html>

within a reasonable timeframe. These consequences enable the Commissioner to make a tax assessment based on the information she has available and to prevent information that was requested, but not provided to the Commissioner, from being admitted as evidence in a dispute or court proceeding.

It is similar to section 21 of the Tax Administration Act 1994 which can be applied in relation to requests for information from a person claiming a deduction for a payment that the person has made to an offshore person.

New section 21BA applies when all of the following requirements are met:

The Commissioner has requested, under section 17, information or documents from a large multinational group member and the information relates to the large multinational group or to a member of the large multinational group; and

That group member has failed to provide a response within three months, or has provided a misleading, incomplete or otherwise inadequate response; and

The Commissioner has provided a further notice to the group member and the member has still failed to provide a sufficient response within 1 month of the further notice.

If these requirements are met section 21BA allows the Commissioner to impose the following consequences on the large multinational group:

- the Commissioner may rely on information that she holds to make a tax assessment of the group member or another member of the large multinational group and to apply any relevant criminal or civil penalties to the large multinational group. Any resulting assessment should be soundly based on the law and the information that is available to the Commissioner.
- If the large multinational group disputes the assessment or penalties the requested information will not be allowed as evidence in the dispute in a court proceeding (unless a court or authority determines that the information request was unreasonable and admitting the evidence is necessary to avoid manifest injustice).

Subsection 21BA(1) outlines the scenarios where section 21BA can be applied. Subparagraph (a) deals with the case where no response is provided within three months.

Subparagraph (b) deals with cases where a response is provided but the Commissioner considers the response to be misleading, including where relevant information has been omitted from the response.

Subparagraph (c) deals with cases where the response omits the information that the Commissioner requires to check compliance with the transfer pricing rules or attributing income to a permanent establishment. Subparagraph (c) can apply regardless of whether or not the relevant information is in the knowledge, possession, or control of the member. This ensures the consequences under section 21 can still be applied where the information does not exist because the multinational group has not prepared transfer pricing documentation or has not attempted to calculate the profits attributable to a permanent establishment. In the absence of this subparagraph, multinationals would be incentivised not to prepare or retain this information.

Subparagraph (d) deals with any other case where a response has been provided but the Commissioner does not consider the response fulfils the requirement of the section 17 request.

Civil penalty for failure to provide the requested information

New section 139AB provides the Commissioner of Inland Revenue with the ability to impose a civil penalty of up to \$100,000 on large multinational groups which fail to comply with a section 17(1CB) request for information or documents.

Section 17(1CB) is explained above, but for this section to apply the information or document must be relevant to the taxation of the large multinational group and be in the knowledge, possession, or control of the member or another member of the large multinational group.

Like other civil penalties, the civil penalty in section 139AB is treated as an additional tax liability for the purpose of late payment penalties and the use of money interest rules.

Section 142GB provides that the due date for the civil penalty is the date specified by the Commissioner in the notice of the assessment of the penalty but which must be at least 30 days after the date the notice is issued.

Criminal penalties cannot typically be applied in relation to a request made in relation to information held by another member of the large multinational group under section 17(1CB). The criminal penalties in section 143 and 143A of the Tax Administration Act 1994 are not modified by the new legislation. There are some existing defences which mean the criminal penalties in section 143(2) and 143A(2) of the Tax Administration Act 1994 do not apply when the information is not in the knowledge, possession or control of the person or a non-resident who is controlled by the person.

Example

As part of an investigation of transfer pricing positions taken by S Co, a New Zealand subsidiary of a large multinational group, the Commissioner of Inland Revenue asks the New Zealand subsidiary to provide certain transfer pricing documentation including the local file of S Co and certain information from the local file of H Co, a group member in Singapore which has entered into transfer pricing arrangements with S Co.

S Co provides their local file but does not provide any of the requested information from the local file of H Co.

On 1 August, the Commissioner provides in writing a section 17 notice to S Co to formally request certain information from the local file of H Co. S Co does not respond to the request.

On 1 November (3 months after the issue of the section 17 notice), the Commissioner provides a second notice to notify that if S Co does not provide the further information by 1 December (30 days after the second notice was issued) that section 21BA may be applied. S Co responds indicating it is not able to provide the requested information.

The Commissioner makes an assessment of S Co based on the information available in S Co's local file as well as other information on comparable arrangements from databases and issues a notice of proposed assessment to S Co stating that she has applied section 21BA(2) when making this assessment as she does not have access to the information requested from H Co's local file.

The assessment is for additional tax of \$4m as well as a civil penalty of \$100,000 under section 139G from failing to comply with the section 17 request.

Due to section 21BA(3), S Co will typically be unable to use the transfer pricing documentation from H Co's local file that was previously requested and not provided to the Commissioner to dispute the Commissioner's assessment of S Co's tax positions.

COLLECTING UNPAID TAX FROM LARGE MULTINATIONAL GROUPS

Section HD 30

Background

Inland Revenue has strong powers to collect revenue from persons who are residents of New Zealand or who have a physical presence here. However, it can be difficult for Inland Revenue to collect tax from non-resident companies that have no physical presence in New Zealand, including in cases where they are a member of a large multinational group which does have a subsidiary or permanent establishment in New Zealand.

Key features

New section HD 30 will allow Inland Revenue to collect tax owed by a non-resident member of a large multinational group from another wholly-owned group member who is a New Zealand resident or that has a permanent establishment in New Zealand.

The rule does this by treating the other group member as an agent for the unpaid tax of the principal member (the non-resident) that owes the tax.

The rule will only apply if the principal member (the non-resident) fails to pay the unpaid tax and if the Commissioner notifies the wholly-owned group member that they will be treated as an agent for the unpaid tax.

The agent can be a non-resident who is treated as having a permanent establishment in New Zealand under the new section GB 54 (Arrangements involving establishments and non-resident businesses).

The agent will have the same dispute rights as the principal member. The rights of an agent are given by section 44 of the Tax Administration Act and include rights of objection under section 44(3) to an assessment under section 44(2).

Application date

New section HD 30 applies from 27 June 2018, which is the date that the Act received the Royal assent. This means that these new powers can be used by Inland Revenue after 27 June 2018 when pursuing current or new investigations, even if those investigations cover income years prior to the date of enactment.

COUNTRY-BY-COUNTRY REPORTS

Section 78G of the Tax Administration Act 1994

Background

One of the OECD's BEPS recommendations was to require large multinational groups (those with annual consolidated group revenue of EUR €750m or more in the previous financial year) to provide a Country-by-Country report which contains certain high-level information on the groups' global activities to tax authorities who would then exchange this information with each other.

The following aggregate information will need to be collected for 2016 and subsequent years for **each jurisdiction** in which the impacted groups operate:

- gross revenues (broken down into related party and unrelated party categories);
- profit (loss) before income tax;
- income tax paid (on cash basis);
- income tax accrued (current year);
- stated capital;
- accumulated earnings;
- number of employees; and
- tangible assets other than cash and cash equivalents.

In addition, impacted groups will need to list all of their entities that are resident in each jurisdiction, noting also the main business activity of each entity.

This information will assist tax authorities in providing them with a starting point for assessing risk and potentially requesting more detailed information that could be used to investigate a multinational's tax position.

Inland Revenue requires New Zealand headquartered multinational groups with annual consolidated group revenue of EUR €750m or more in the previous financial year to file a Country-by-Country report for all income years beginning on or after 1 January 2016.

This requirement currently applies to about 20 multinational groups, who have been notified by Inland Revenue.

A specific legislative provision to require multinationals to file Country-by-Country reports is not strictly necessary as Inland Revenue is already able to use section 17 of the Tax Administration Act 1994 to enforce these requirements. A specific provision is useful because it will provide a more explicit signal to the affected multinationals and other countries of New Zealand's commitment to Country-by-Country reporting. For example, accounting firms produce information about each country's relevant reporting requirements and they may not realise New Zealand is requiring Country-by-Country reports to be prepared and filed if they are not mentioned in our relevant tax legislation.

Section 17 allows the Commissioner to request a taxpayer to provide specific information.

Application date

Section 78G applies from 27 June 2018, which is the date that the Taxation (Neutralising Base Erosion and Profit Shifting) Act entered into force.

For the periods from 1 January 2016 to 27 June 2018, Inland Revenue will continue to use the existing requirement in section 17 of the Tax Administration Act 1994 to require the affected New Zealand headquartered multinational groups to provide Country-by-Country reports.

Detailed analysis

New section 78G applies to large multinational groups with an ultimate owner who is a resident of New Zealand.

A large multinational group is defined in section YA 1 as a consolidated accounting group that has annual consolidated group revenue of more than EUR €750m (which is the exemption threshold described in paragraph 5.52 of the OECD Transfer Pricing Guidelines). This EUR €750m revenue threshold was agreed by the OECD as a way to define the large multinational groups that are required to file Country-by-Country reports with relevant tax authorities.

The revenue threshold is measured using the consolidated accounts for the preceding income year or period prior to the relevant income year.

Example

X Co is a resident of New Zealand and is the parent company of a multinational group. X Co's consolidated accounts reported revenues of NZ \$1.2b, which exceeds EUR €750m for the year ending July 2018. For their next income year ending July 2019, X Co will be required to file a Country-by-Country report with Inland Revenue.

In the income year ending July 2019 X Co's consolidated accounts has reported revenues of NZ \$1.1b, which for that year is less than EUR €750m. For their next income year ending July 2020, X Co will not be required to file a Country-by-Country report.

To be a “large multinational group” under section YA 1 of New Zealand’s legislation, the group must also have a member resident in New Zealand or income with a source in New Zealand and a member who is resident in a country or territory other than New Zealand.

Unlike some other provisions in Taxation (Neutralising Base Erosion and Profit Shifting Act 2018) which apply to all large multinational groups (as defined in section YA 1), the Country-by-Country reporting requirement in section 78G of the Tax Administration Act 1994 only applies to large multinational groups whose ultimate owner is a resident of New Zealand (approximately 20 groups).

The “ultimate owner” is the parent entity that is required to prepare consolidated accounts that includes their subsidiaries (these consolidated accounts will include consolidated amounts from the other group members) and for which there is no other entity that owns directly or indirectly a controlling interest in the parent whereby that other entity would be required to prepare consolidated accounts that include the parent entity.

New Zealand’s financial reporting requirements currently require large entities (including companies, partnerships and limited partnerships) to prepare accounts regardless of whether the entity is listed on a stock exchange. For these preparation requirements “large” is defined in the Financial Reporting Act 2013 as entities that earn over NZ\$30m of consolidated revenues (which is smaller than EUR 750m) or that have over NZ\$60m of consolidated assets in the previous two years.

New Zealand is a relatively small jurisdiction which allows Inland Revenue to readily identify any large organisation headquartered here that should be subject to Country-by-Country reporting requirements. In the very unlikely event that such an organisation did not prepare consolidated financial statements, Inland Revenue would use section 17 of the Tax Administration Act 1994 to specifically request this information.

Example

Y Co is a resident of New Zealand and is a member of a large multinational group. However, Y Co is a subsidiary of Z Co which is a resident of Australia. Z Co is the parent company of the multinational group. Y Co will **not** be required to file a country-by-country report in New Zealand, but Z Co is required to file a Country-by-Country report with the Australian Tax Office in Australia. Inland Revenue will receive Z Co’s Country-by-Country report information when these reports are exchanged under the *Multilateral Competent Authority Agreement on the exchange of Country-by-Country Reports*.

Large multinational groups with an ultimate owner that is a resident of New Zealand are required to disclose a Country-by-Country report to the Commissioner that includes:

- The information described in Annex III of Chapter V of the OECD transfer pricing guidelines. This annex includes the OECD template for the Country-by-Country report.
- Other information as may be required by the Commissioner. This provides flexibility for future changes to the Country-by-Country report or any additional information that the Commissioner may require.

The OECD transfer pricing guidelines include a template for the Country-by-Country report and instructions and definitions for the compiling the information in the template in Annex III of Chapter V of the guidelines.

The deadline for filing a Country-by-Country report is within the 12 months after the 12 month period to which the information in the report relates.

For example a Country-by-Country report relating to 1 January 2019 to 31 December 2019 would need to be filed with Inland Revenue on or before 31 December 2020. Inland Revenue would then exchange this report with other countries by July 2021.