# International treaty examination of the Agreement between the Czech Republic and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Report of the Finance and Expenditure Committee

The Finance and Expenditure Committee has conducted an international treaty examination of the Agreement between the Czech Republic and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and has no matters to bring to the attention of the House.

The national interest analysis for the Agreement is appended to this report.

Charles Chauvel MP
Chairperson

## Appendix A

## National interest analysis— Agreement between the Czech Republic and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

### Executive summary

1 The purpose of the Agreement between the Czech Republic and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income ("the Czech DTA") is to eliminate double taxation of income flows between the Czech Republic and New Zealand. The Czech DTA will generally reduce withholding taxes on dividends, interest and royalties and will exempt many short-term activities of individuals and businesses in the host country. Where both countries are permitted to impose tax, it will ensure that the country of residence allows a credit for the tax paid in the country of source. The Czech DTA will provide taxpayers with greater certainty of tax treatment, along with a dispute resolution procedure. It will also assist in the prevention of tax avoidance and evasion.

### Date and nature of proposed binding treaty action

2 The Agreement between the Czech Republic and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income ("the Czech DTA") was signed in Prague on 26 October 2007. Subsequent to signature and satisfactory completion of the Parliamentary treaty examination process, it is proposed that the Czech DTA be incorporated into domestic legislation through an Order in Council, and brought into force, in accordance with Article 26, through an exchange of notes through the diplomatic channel, confirming completion of all necessary domestic procedures for entry into force. The Czech DTA will enter into force on the date of the later note.

### Reasons for New Zealand becoming party to the treaty

3 New Zealand currently has 33 Double Tax Agreements (DTAs) in force. They are primarily aimed at reducing tax impediments to cross-border trade and investment, but also help tax administrations to detect and prevent tax avoidance and tax evasion.

4 New Zealand taxes its residents on their worldwide income. Non-residents are taxed on their New Zealand-sourced income. The Czech Republic taxes its residents and non-residents on a similar basis. This gives rise to the possibility that income flows between New Zealand and the Czech Republic will be subject to double taxation. The Czech DTA provides for the elimination of such double taxation, by means of an allocation of taxing rights between the two countries and through supporting mechanisms such as the requirement to provide tax credits. The Czech DTA also provides greater certainty of tax treatment for residents of the two countries engaging in trade and investment with the other country. Overall, the Czech DTA can be expected to foster trade and investment between New Zealand and the Czech Republic.

5 Tax administrations are privy to sensitive financial and personal information. This information is generally held subject to strict confidentiality requirements. DTAs override these confidentiality rules and ensure that tax administrations can request from each other information that will assist in the prevention of tax avoidance and tax evasion. Information obtained under DTAs, however, can only be disclosed to specified persons, and may only be used for authorised purposes.

6 New Zealand's current levels of trade and investment with the Czech Republic are modest. In the year to December 2004 New Zealand exported goods worth NZ$3.08 million to the Czech Republic, primarily wool, while the Czech Republic exported goods worth $26.52 million to New Zealand, principally motor cars. However potential exists for growth as evidenced by the fact that the Czech Republic was traditionally one of New Zealand's larger export markets in Central Europe before Czechoslovakia split into two republics in 1993. The Czech Republic is a recent EU accession state. Like other recent EU accession states, the Czech Republic favours source taxation (as opposed to residence taxation), which is also preferred by New Zealand. Therefore, the two countries share a common interest in preserving source taxation. The Czech Republic is also a member of the OECD and New Zealand's position is to give priority to OECD member countries who request DTAs.

7 The Czech DTA follows the New Zealand negotiation model very closely. This negotiation model sets out New Zealand's preferred DTA provisions, which differ from the OECD Model Tax Convention in many places. The wording of some provisions varies slightly from that in the New Zealand model but these differences do not result in any substantive departures from New Zealand's general treaty policy of protecting source income taxation. The Czech DTA will be a valuable precedent for future DTA negotiations.

## Advantages and disadvantages to New Zealand of the treaty entering into force and not entering into force

8 The advantages to New Zealand of the Czech DTA entering into force are:

- it will remove tax impediments to cross-border transactions between New Zealand and the Czech Republic—in particular, it will share the cost of relieving the double taxation of income. The Czech DTA will regulate how transactions should be taxed between the two countries so the income is effectively taxed only once
- it will generally reduce withholding taxes on dividends, interest and royalties to 15 percent, 10 percent and 10 percent respectively, and will exempt many short-term activities of individuals and businesses in the host country
- when both New Zealand and the Czech Republic are permitted to impose tax, it will ensure that the country of residence allows a credit for the tax paid in the country of source
- the Czech DTA will provide taxpayers with greater certainty of tax treatment, along with a mutual agreement procedure for resolving disputed issues that may arise in relation to the Czech DTA

- the Czech DTA will also assist the tax administrations of both New Zealand and the Czech Republic by facilitating the exchange of information relating to taxes for the prevention of avoidance and evasion.

9 One disadvantage of the Czech DTA is that it will require New Zealand to forgo some revenue because of the reduction in levels of New Zealand tax and the allocation of some taxing rights to the Czech Republic. Although, as explained in the discussion further below, these revenue costs should be offset by corresponding increases in revenue (arising from reciprocal allocation of taxing rights to New Zealand and reductions of Czech Republic tax; a reduction in avoidance and evasion of New Zealand tax, and an increase in trade and investment).

10 The requirement for New Zealand to provide the Czech Republic with requested information on tax matters under the Czech DTA's exchange of information provisions (Article 23 of the Czech DTA) may be seen as a disadvantage. However, again, the ability to request information is reciprocal, and New Zealand's experience with exchange of information in relation to its 33 other DTAs is predominantly positive; the benefit gained from being able to request information from the other country more than offsets the administrative burden of having to provide information pursuant to its requests.

11 Not signing or otherwise progressing the Czech DTA to entry into force is an option. However, in that case the potential benefits to New Zealand in terms of increased trade and investment, and reduced tax avoidance and evasion, will be forgone. The point of a DTA is to make concessions on a reciprocal basis with the other country. Such concessions can only be secured through the negotiation of a DTA.

12 On balance, it is in New Zealand's interest to conclude the Czech DTA.

## Legal obligations which would be imposed on New Zealand by the treaty action, the position for reservations to the treaty, and an outline of any dispute settlement mechanisms

13 The Czech DTA will not impose requirements on taxpayers. The obligations it imposes are on the Contracting States, restricting their taxing rights under domestic law on a reciprocal basis and requiring the provision of assistance in the exchange of information in relation to tax matters. The Czech DTA does not require the imposition of a tax that is not already imposed under domestic law.

14 Under the Czech DTA, New Zealand and the Czech Republic will be required to comply with the following rules when imposing tax on residents of either country:

- income from immovable property will generally be taxed in the country where the property is situated (Article 6 refers)
- business profits will generally be taxable only in the country where the business is resident. However, the profit attributable to a "permanent establishment" situated in the other country may be taxed in that country. A "permanent establishment" generally exists in the country in question when there is a fixed place of business where the business of an enterprise is carried on (Article 7 refers)

- profits of an enterprise of a country from the operation of ships or aircraft will generally be taxable only in that country, although profits from the carriage of passengers and cargo between New Zealand ports will remain subject to New Zealand tax (Article 8 refers)
- dividends may generally be taxed in both countries. However, the country from which the dividends are paid may not impose tax in excess of 15 percent if the dividends are paid to a resident of the other country (Article 10 refers)
- interest may generally be taxed in both countries. However, the country in which the interest arises may not impose tax in excess of 10 percent if the interest is paid to a resident of the other country (Article 11 refers)
- royalties may generally be taxed in both countries. However, the country in which the royalties arise may not impose tax in excess of 10 percent of the royalties if they are paid to a resident of the other country (Article 12 refers)
- specific rules apply to the taxation of income, profits or gains derived from the sale of property. In the case of immovable property the profits remain taxable in the country in which the property is situated (Article 13 refers)
- income from employment will be taxable only in the country where the employee is resident, unless the employment is performed in the other country. In that case, the country where the employment is performed may also tax the income, but only if the employee is present for at least 183 days and various conditions are met (Article 14 refers)
- directors' fees may be taxed in the country where the relevant company is resident (Article 15 refers)
- entertainers and sportspersons may be taxed in the country in which their activities take place (Article 16 refers)
- pensions and other similar remuneration are only taxable in the country where the recipient is resident (Article 17 refers)
- salaries and wages for services to a Government of one country are generally exempt from tax in the other country (Article 18 refers)
- students are generally not taxed on payments received from outside the country when those payments are for the maintenance and education of the student (Article 19 refers)
- New Zealand has to comply with the various administrative requirements of the Czech DTA that make its operation possible. These include, in particular, the elimination of double taxation by exempting or giving credits for overseas tax paid in certain situations; complying with the mutual agreement procedures set out in the Czech DTA; and complying with the exchange of information procedures (Articles 21, 22 and 23 refer)
- reservations are not provided for under the Czech DTA

- Article 22 of the Czech DTA provides that any difficulties or doubts arising as to the interpretation or application of the treaty are to be resolved by mutual agreement between the Competent Authorities.

## Measures which the Government could or should adopt to implement the treaty action, including specific reference to implementing legislation

15 The Czech DTA will need to be implemented domestically by Order in Council in accordance with section BH 1(3) of the Income Tax Act 2004. Section BH 1 of the Income Tax Act 2004 enables DTAs to be given effect by Order in Council. It also provides that DTAs will override the Income Tax Act 2004, the Tax Administration Act 1994, any other Inland Revenue Act, the Official Information Act 1982, the Privacy Act 1993 in relation to income tax, unpaid tax and the exchange of information relating to a tax. This override is necessary to give effect to the terms of a DTA, since they allocate taxing rights. This means that New Zealand foregoes some taxing rights available under the Inland Revenue Acts in certain circumstances. The Official Information Act is overridden to ensure that communications with other states during DTA negotiations are not disclosed. The Privacy Act is overridden to ensure that information can be exchanged regarding natural persons under the exchange of information provision (Article 23 of the Czech DTA).

16 Subject to satisfactory completion of Parliamentary treaty examination, the Order in Council would be promulgated and would come into effect twenty-eight days after being published in the Gazette.

## Economic, social, cultural and environmental costs and effects of the treaty action

17 No social, cultural or environmental effects are anticipated.

## Costs to New Zealand of compliance with the treaty

18 New Zealand may forgo some revenue from the limitation of our taxing rights in relation to income flows between New Zealand and the Czech Republic that we are currently able to tax under our domestic laws. This revenue cost could include, for instance, tax forgone in relation to short-term activities of residents of the Czech Republic in New Zealand, which the Czech DTA will exempt. It could also include tax forgone on dividends, interest and royalties paid by New Zealand residents to the residents of the Czech Republic in respect of which the Czech DTA will lower withholding rates.

19 The Czech Republic will also be similarly constrained from taxing certain income flows between the two countries and this reduced tax will often flow through to the New Zealand tax base through a reduction in credits for foreign tax paid. It is likely that these factors will offset each other to some extent over time. Further, Inland Revenue's ability to obtain information from the Czech tax authorities under the Czech DTA and thus reduce tax evasion and avoidance may also assist in offsetting the foregone revenue.

20 To the extent that the cost to the New Zealand revenue is not fully offset by a reduction in creditable Czech Republic tax or a reduction in levels of tax avoidance and evasion, it is expected that the economic benefits of the Czech DTA will outweigh these costs.

## Completed or proposed consultation with the community and parties interested in the treaty action

21 The Treasury and the Ministry of Foreign Affairs and Trade have been consulted on and agree with the proposed treaty action. Consultation was undertaken by providing drafts of this document and the accompanying Cabinet Paper for comment.

## Subsequent protocols and/or amendments to the treaty and their likely effects

22 No future amendments are anticipated and the Czech DTA makes no provision for amendments. However, if the need to amend the Czech DTA arises, this can be achieved by means of a Protocol.

## Withdrawal or denunciation provision in the treaty

23 Article 27 of the Czech DTA provides that either New Zealand or the Czech Republic may terminate the Czech DTA by giving notice of termination, through diplomatic channels, on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force.

## Adequacy statement

24 The Inland Revenue Department has prepared this extended NIA and has assessed it as adequate in accordance with the Code of Good Regulatory Practice.

Prepared by: Inland Revenue Department

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