



International treaty examination of the Agreement between the Government of New Zealand and the States of Guernsey for the Exchange of Information with Respect to Taxes and the Allocation of Taxing Rights with Respect to Certain Income of Individuals

Report of the Finance and Expenditure
Committee

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Recommendation

The Finance and Expenditure Committee recommends that the House take note of its report.

The Finance and Expenditure Committee has conducted an international treaty examination of the Agreement between the Government of New Zealand and the States of Guernsey for the Exchange of Information with Respect to Taxes and the Allocation of Taxing Rights with Respect to Certain Income of Individuals and has no matters to bring to the attention of the House.

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

Appendix A

Committee procedure

The committee met on 21 and 28 April 2010 to consider the agreement.

Committee members

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Amy Adams

David Bennett

John Boscawen

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Hon David Cunliffe

Aaron Gilmore

Raymond Huo

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Appendix B

Agreement between the Government of New Zealand and the States of Guernsey for the Exchange of Information with Respect to Taxes and the Allocation of Taxing Rights with Respect to Certain Income of Individuals

National Interest Analysis

Executive Summary

1 On 21 July 2009, New Zealand a tax-related agreement with Guernsey: the Agreement Between The States Of Guernsey And The Government Of New Zealand For The Exchange Of Information With Respect To Taxes And The Allocation Of Taxing Rights With Respect To Certain Income Of Individuals (“the TIEA”).

2 The TIEA establishes a mechanism by which tax officials from New Zealand and Guernsey (“the Parties”) can request information from each other (such as business books and accounts, bank information, and information on the ownership of legal entities) for the purpose of detecting and preventing tax avoidance and evasion. Access to this previously unobtainable information will enhance New Zealand Inland Revenue Department’s ability to detect and prevent tax avoidance and tax evasion. Any reduction in tax avoidance or tax evasion will be beneficial to New Zealand in financial, fiscal and economic terms. New Zealand already has a network of 35 exchange of information arrangements in place through its double tax agreements (“DTAs”) with key trading and investment partners. TIEAs are designed to be used to establish exchange of information arrangements with jurisdictions where DTAs may not be appropriate, such as with low-tax jurisdictions. Guernsey is a low-tax jurisdiction, and is also an important international finance centre. New Zealand, to date, has signed two other TIEAs – with the Netherlands Antilles, in 2007, and with Bermuda, earlier this year.

3 The TIEA is based on a model produced in 2002 by the Organisation for Economic Cooperation and Development (“the OECD”). The TIEA provides a comprehensive set of rules that support the exchange of information. These rules ensure that requested information will be obtained and provided in a timely and effective manner. However, the rules also ensure that information may not be requested or used indiscriminately. Information requests may only be made in prescribed circumstances, and information received pursuant to a request may only be disclosed to authorised persons and used by those persons for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the respective Party.) The text of the TIEA is attached as Annex A.

4 The TIEA contains articles that allocate taxing rights in respect of government service and students (“the additional articles”), following the approach adopted for such articles in our DTAs. The TIEA and additional articles collectively constitute a “package deal”. Although the TIEA applies on a reciprocal basis, the limited nature of Guernsey’s tax system means that it will derive little benefit from the TIEA whereas New Zealand

stands to gain considerable benefit. The additional articles were therefore offered by New Zealand as part of a number of measures intended to ensure that Guernsey also receives some benefit from entering into exchange of information arrangements with New Zealand. (It is not appropriate to enter into a full DTA with Guernsey, given the mismatch in tax systems. However, the government service and students articles are two DTA articles that can be agreed with Guernsey as they will not give rise to any significant financial, fiscal or economic costs.) The TIEA also includes an article that will establish a “best endeavours” mutual agreement procedure that can be invoked in respect of transfer pricing adjustments. New Zealand will not gain any direct benefit from agreeing to the additional articles. The additional articles, however, supports the conclusion of the TIEA, and New Zealand will therefore benefit indirectly.

5 A second key measure offered by New Zealand as encouragement to the Guernsey to enter into the TIEA, is found in article 12 of the TIEA. This article constitutes an obligation on the Parties not to impose “prejudicial or restrictive measures based on harmful tax practices” on each other. This obligation relates to the OECD Harmful Tax Practices initiative, in which the prospect of OECD member countries imposing sanctions on or taking other defensive measures against jurisdictions identified as having harmful tax practices has previously been raised. The key identifier of harmful tax practices is whether a jurisdiction engages in effective exchange of information on tax matters. Given that the TIEA provides for full exchange of information on tax matters with Guernsey, it would be inappropriate for New Zealand to impose any such measures on Guernsey while the TIEA is in force. The provision was included in recognition of this, but was expressed as a reciprocal obligation on both Parties.

6 The TIEA will be supported by two less-than-treaty status instruments. The first instrument is an Understanding between the New Zealand and Guernsey tax authorities that contains additional clarification on technical issues such as the meaning of terms used in the agreements. The second instrument is a Joint Declaration between the two Governments that contains reciprocal comments about each Government’s recognition of the other as having committed to various international standards (such as combating money laundering and terrorist financing) and cooperation in tax matters. The Joint Declaration also contemplates the possibility of future discussions that might be entered into with a view to broadening and strengthening the political and economic relationship between the Governments.

Date and nature of proposed binding treaty action

7 Before the TIEA is brought into force for New Zealand it must first be submitted to the House of Representatives to undergo Parliamentary treaty examination, in accordance with Standing Orders 388 to 391. (The less-than-treaty status Arrangement and Joint Declaration do not create legally binding commitments for New Zealand and are not required to undergo treaty examination.)

8 Subsequent to satisfactory completion of the Parliamentary treaty examination process, the TIEA can then be incorporated into domestic legislation by Orders in Council pursuant to section BH 1 of the Income Tax Act 2007.

9 Upon the promulgation of the Orders in Council, the agreements can then each be brought into force, in accordance with article 13 of the TIEA, through an exchange of

diplomatic notes that confirms the completion of the respective constitutional and legal requirements for entry into force by each Party.

10 The TIEA will enter into force on the completion of the exchange of diplomatic notes. Upon entry into force, the TIEA will apply prospectively to all taxable periods beginning on or after that date (or, where there is no taxable period, to all charges to tax arising on or after that date).

Reasons for New Zealand taking the treaty action

The TIEA

11 New Zealand domestic law specifically prohibits Inland Revenue from divulging information it holds to foreign jurisdictions, except when authorised by a tax treaty.¹ Other countries generally follow the same principle. Therefore, to assist in the detection and prevention of tax avoidance and tax evasion, most developed countries are building networks of treaties that allow for the exchange of information on tax matters.

12 The most common type of tax treaty in which exchange of information provisions feature are DTAs. New Zealand currently has 35 DTAs in force. However, DTAs are typically only concluded between trading and investment partners with broadly similar tax systems. To cater for other situations, the OECD, in 2000, produced a model TIEA (with a comprehensive commentary) that provides solely for the exchange of information on tax matters. The OECD also, in 2000, published a list of low-tax international finance centres with which member countries are encouraged to negotiate TIEAs, based on the OECD model TIEA.² The 2000 list includes Guernsey.

13 New Zealand signed its first TIEA, with the Netherlands Antilles, on 1 March 2007. A second TIEA, with Bermuda, was signed on 16 April 2009. Each new TIEA concluded further expands New Zealand's network of exchange of information arrangements and reduces the tax evasion and avoidance options available to New Zealand residents.

14 The TIEA with Guernsey provides a comprehensive set of rules to support the exchange of information. These rules are designed to ensure that requested information is obtained and provided in a timely and effective manner. The TIEA, however, also ensures that information is not to be requested or used indiscriminately. Requested information must be “foreseeably relevant” to the tax affairs of a particular person or entity. (The OECD commentary clarifies that this means the Parties are not at liberty to engage in “fishing expeditions”.) In addition, information received pursuant to a request may only be disclosed to authorised persons and may only be used by those persons for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the respective Party.)

¹ Sections 81 and 88 of Tax Administration Act 1994 refer. The term “double tax agreement”, as used in section 88, has (by virtue of its legislative definition) the same meaning as that outlined in paragraph 8 above. Section 88 is therefore also applicable to TIEAs. The preamble of the TIEA contains a reference to “present legislation under which the parties may already exchange information in criminal tax matters”. In the case of New Zealand, this refers to the potential ability of New Zealand to provide assistance under the Mutual Assistance in Criminal Matters Act 1992.

² The 2000 OECD report “Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices” refers.

15 Interference from bank secrecy and domestic tax interest rules is specifically prohibited as an obstacle to effective information exchange.³ Otherwise, rights and safeguards secured to residents of either jurisdiction by domestic law or administrative practice remain in effect. In particular, as noted above, the Parties are required to maintain strict confidentiality in relation to any information received pursuant to a request.

16 Although the TIEA applies on a reciprocal basis, Guernsey only has a limited tax system. Guernsey will therefore only rarely have any need to request information on tax matters from other countries. New Zealand, by contrast, has a comprehensive tax system and imposes income tax on the worldwide income of its tax residents. New Zealand therefore has a keen interest in ensuring that it can obtain information on the income earning activities of those tax residents in foreign jurisdictions. Accordingly, New Zealand has a much greater interest in concluding a TIEA than Guernsey, and can expect to derive greater benefits from the TIEA than will Guernsey.

17 To address this imbalance, New Zealand has adopted the approach of other OECD member countries in TIEA negotiations and offered Guernsey a “benefits” package. The additional articles are a key element of that package. The additional articles allocates taxing rights in respect of government service and students, and is based on articles that appear in New Zealand’s DTAs. New Zealand also offered to establish a mutual agreement procedure that can be invoked in respect of transfer pricing adjustments as part of the package.⁴

18 New Zealand generally only enters into arrangements for the allocation of taxing rights in its DTAs. However, as noted above, DTAs are typically concluded between trading and investment partners with broadly similar tax systems. In such cases the concession of taxing rights is reciprocal. That is, New Zealand may give up a taxing right but the other country will also give up a taxing right in reciprocal circumstances. In financial terms, these reciprocal reductions tend to offset each other (for example, reduced tax in the other jurisdiction generally results in a reduced foreign tax credit against the New Zealand tax base). However, given Guernsey’s limited tax system, entering into a DTA with Guernsey would mean New Zealand giving up taxing rights with little if any reciprocity.

19 For this reason, New Zealand’s proposal for the additional articles was limited to those DTA articles that will not give rise to any significant financial, fiscal or economic costs. Nor will they provide a commercial advantage to individuals or entities operating in Guernsey. In the negotiations, the additional articles were ultimately limited to the following:

³ This is a key aspect of the TIEA. Access to bank information on transactions and savings assists tax administrations in determining whether a person has correctly declared their income. Bank secrecy rules prevent the disclosure of bank information, and therefore facilitate tax evasion. TIEAs override any such domestic bank secrecy rules with an explicit treaty obligation to provide bank information. Domestic Tax Interest rules prohibit a jurisdiction from complying with a request for information if that jurisdiction itself does not itself need that information for tax purposes. TIEAs therefore also override any domestic tax interest rules with an explicit treaty obligation to provide information regardless of whether or not there is a domestic interest.

⁴ Transfer pricing rules enable a tax authority to adjust profits where transactions between associated enterprises have been entered into on other than “arm’s length” terms (i.e. where prices have been artificially set to derive a tax advantage).

- Pursuant to article 9 of the TIEA, remuneration paid by the Government of one jurisdiction to an individual in respect of services rendered to that Government will be exempt from income tax in the other jurisdiction. However, this rule does not apply if the individual is a tax resident of that other jurisdiction (unless the individual became resident solely by reason of the rendering of those services). The article will therefore only apply when a Guernsey Government official comes to New Zealand in an official capacity. Such visits are likely to be minimal. In any case, New Zealand generally does not tax salaries and wages earned in New Zealand where the visit is for less than 90 days.
- Pursuant to article 10 of the TIEA, where a student or business apprentice who is a tax resident of one jurisdiction is temporarily present in the other jurisdiction solely for the purpose of their education or training, payments which they receive from outside that other jurisdiction for their maintenance, education or training will be exempt from income tax in that other jurisdiction. As New Zealand generally does not tax payments of this type, the article will have few implications.
- Pursuant to article 11 of the TIEA, a mutual agreement procedure can be invoked by a resident of one jurisdiction if they consider that the other jurisdiction has made an inappropriate transfer pricing adjustment. Although the TIEA provides that the Parties must endeavour to resolve the issue, there is no obligation on New Zealand to change its position in any case where it considers that the transfer pricing rules have been applied correctly. (This is consistent with the outcome that arises under the mutual agreement procedure of New Zealand's existing DTAs.)

20 The text of the TIEA is attached as Annex A.

The less-than-treaty status instruments

21 The TIEA will be supported by two less-than-treaty status instruments. The first instrument is an Understanding between the New Zealand and Guernsey tax authorities that contains additional clarification on technical issues such as the meaning of terms used in the agreements. The second instrument is a Joint Declaration between the two Governments that contains reciprocal comments about each Government's recognition of the other as having committed to various international standards (such as combating money laundering and terrorist financing) and cooperation in tax matters. The Joint Declaration also contemplates the possibility of future discussions that might be entered into with a view to broadening and strengthening the political and economic relationship between the Governments.

22 The less-than-treaty status Understanding and Joint Declaration do not create legally binding commitments for New Zealand. They are therefore not required to undergo treaty examination.

Consideration of other options

23 New Zealand's objective in negotiations was to secure effective exchange of information arrangements with Guernsey. The only other possible treaty mechanism for entering into such arrangements with Guernsey would be as part of a DTA. However, DTAs are designed to be concluded between trading and investment partners with broadly similar tax systems. As noted above, the fact that DTAs allocate taxing rights means that

New Zealand would stand to lose tax revenue if it were to enter into a DTA with Guernsey.

24 New Zealand’s offer of “benefits” to Guernsey was made at a time when Guernsey had little interest in entering into exchange of information arrangements with New Zealand. It followed the precedent established by other OECD countries in offering benefits. Recent developments, such as the 2 April 2009 G20 Leaders Summit in London, have increased international pressure on international finance centres to enter into effective exchange of information arrangements. This increased pressure may to some extent lessen the need to provide benefits to induce those international finance centres to enter into exchange of information arrangements. However, it would be inappropriate for New Zealand to consider withdrawing its offer of benefits.

Advantages and disadvantages to New Zealand of the treaty action

25 The TIEA will enable New Zealand tax officials to request tax records, business books and accounts, bank information, and ownership information from Guernsey. Access to this previously unobtainable information will enhance the New Zealand Inland Revenue Department’s ability to detect and prevent tax avoidance and tax evasion. (The TIEA permits New Zealand to request information in relation to “taxes of every kind and description”. Its likely principal application, however, will be in respect of income taxes.) Any reduction in tax avoidance or tax evasion will be beneficial to New Zealand in financial, fiscal and economic terms.

26 Guernsey is unlikely to raise many requests for information from New Zealand. If requests for information are received from Guernsey, New Zealand will incur administrative costs in obtaining and providing the requested information. However, streamlined and effective mechanisms for dealing with exchange of information requests have already been established in relation to New Zealand’s existing DTAs and TIEAs. The administrative costs of responding to requests from Guernsey will therefore only be marginal. Experience gained from administering the exchange of information arrangements already in place under New Zealand’s existing tax treaties indicates that the benefits arising from the enhanced ability to reduce tax avoidance and evasion outweigh any of the costs that arise.

27 New Zealand may be required to bear some costs in relation to requests for information that it makes to Guernsey. The less-than-treaty status Understanding referred to in paragraph 21 above sets out the shared understanding of the Parties with respect to costs, as is required by article 8 of the TIEA. “Ordinary” costs of complying with a request will be borne by the requested Party, but “extraordinary costs” (such as the cost of hiring translators or interpreters) will be reimbursed by the requesting Party. However, prior consultation will be required if extraordinary costs appear likely to exceed US\$1000. This will ensure that New Zealand will only progress information requests giving rise to significant reimbursement costs if the need to obtain the information justifies the expenditure.⁵

⁵ In recognition of the possibility that capacity issues in Guernsey may mean that, on occasions, they may struggle to find the staff or other resources to comply with a single or multiple requests for information from New Zealand, the Understanding also provides that the two sides are to consult in such circumstances with a view to finding solutions. For

28 The TIEA contains one article, article 12, not found in the OECD model TIEA. This Article constitutes the second key element of the New Zealand benefits package. Article 12 imposes an obligation on the Parties not to impose “prejudicial or restrictive measures based on harmful tax practices” against each other. This obligation relates to the OECD Harmful Tax Practices initiative, in which the prospect of OECD member countries taking defensive measures to restrain the harmful tax practices of other countries has previously been raised.⁶ The key identifier of harmful tax practices is whether a jurisdiction engages in effective exchange of information on tax matters. Given that the TIEA provides for full exchange of information on tax matters with Guernsey, it would be inappropriate for New Zealand to impose any such measures on Guernsey while the TIEA is in force. The provision was included in recognition of this, but was expressed as a reciprocal obligation on both Parties.

29 On balance, it is in New Zealand’s interests to conclude the TIEA with Guernsey.

Obligations which will be imposed on New Zealand by the treaty action, the position of reservations to the treaty, and an outline of any dispute settlement mechanisms

30 The TIEA places a reciprocal obligation on each Party to provide, upon request, information that is relevant to the administration and enforcement of specified taxes. In the case of Guernsey, the specified taxes are “income tax and dwellings profits tax”. As noted above, Guernsey currently has a very limited tax system, and so is unlikely to make many requests for information from New Zealand.

31 The Parties are required to maintain strict confidentiality in relation to any information received pursuant to a request. Such information may only be disclosed to authorised persons and may only be used for specified purposes (principally the administration and enforcement of the domestic tax laws of the respective Party).

32 In the Understanding, the respective tax authorities set out their shared understanding of how incidents of costs incurred in providing assistance will be addressed. The requesting Party is to reimburse the requested Party for “extraordinary costs” (such as the cost of engaging an interpreter or translator) incurred in responding to the request. Otherwise costs are to be borne by the requested Party. Prior consultation will be required if extraordinary costs appear likely to exceed US\$1000.

33 Both Parties are constrained from imposing “prejudicial or restrictive measures based on harmful tax practices” (the Understanding sets out the shared understanding of how this phrase will be interpreted). New Zealand does not currently impose any such measures and, given that the TIEA provides for full exchange of information on tax

example, where it is vitally important for Inland Revenue to obtain the information, New Zealand may agree to pay a larger share of the costs.

⁶ The 1998 OECD report “Harmful Tax Competition: An Emerging Global Issue” and 2000 OECD report “Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices” refer. The G20 Leaders Summit of 2 April 2009 re-raised the prospect of counter-measures against non-complying jurisdictions. The Leaders Statement from that Summit contained the statement that “we stand ready to deploy sanctions to protect our public finances and financial systems”.

matters with Guernsey, would not contemplate introducing such measures with respect to Guernsey while the TIEA is in force.

34 Reservations are not provided for under the TIEA.

35 Article 11 of the TIEA provides that any difficulties or doubts arising as to the interpretation or application of the TIEA are to be resolved, if possible, by mutual agreement between the competent authorities (for New Zealand, the Commissioner of Inland Revenue or his or her authorised representative; for Guernsey, the Director of Income Tax or the Director's delegate). The Parties may also agree upon other forms of dispute resolution.

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

36 Subject to the successful completion of the Parliamentary treaty examination process, the TIEA will be implemented into New Zealand domestic law by Orders in Council in accordance with section BH 1 of the Income Tax Act 2007. Section BH 1 authorises the giving of overriding effect to DTAs by Order in Council.⁷ Despite the reference to DTAs, the agreements to which the section relates are those that have been negotiated for any one or more of the purposes listed in the section. The facilitation of exchange of information is a listed purpose. Relief from double taxation and relief from tax are also listed purposes. Therefore, the TIEA falls within the ambit of section BH 1.

37 After the Orders in Council have entered into force, New Zealand will notify Guernsey by diplomatic note that all of its domestic constitutional and legal procedures for entry into force of the TIEA are complete. Guernsey will likewise notify New Zealand by diplomatic note when it has completed its domestic constitutional and legal procedures for giving effect to the TIEA. The TIEA will enter into force on the date of the last notification. The provisions will apply prospectively. (For example, this means that the TIEA provisions cannot then be used to obtain information predating entry into force.)

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

38 No social, cultural or environmental effects are anticipated. Any economic effects are expected to be favourable, as noted above.

The costs to New Zealand of compliance with the treaty

39 New Zealand will be required to reimburse Guernsey for extraordinary costs (such as the cost of hiring translators or interpreters) that may arise from a New Zealand request made under the TIEA. However, the Understanding provides for consultation if extraordinary costs appear likely to exceed US\$1000. This will ensure that New Zealand will only progress information requests giving rise to significant reimbursement costs if the need to obtain the information justifies the expenditure.

⁷ That is, the Order in Council may specify that the provisions of the agreement will have effect notwithstanding any provision of the Inland Revenue Acts, the Official Information Act 1982 or the Privacy Act 1993 – although only in relation to tax matters.

40 New Zealand is likely to raise more requests for information than Guernsey but, if requests for information are received from Guernsey, New Zealand will incur administrative costs in complying with those information requests. As noted above, however, streamlined and effective mechanisms for dealing with exchange of information requests have already been established in relation to New Zealand's existing DTA and TIEA network. The administrative costs of responding to requests from Guernsey are therefore expected to be marginal.

41 For the reasons outlined in paragraph 19 above, New Zealand is unlikely to suffer any significant revenue loss from the limitation of taxing rights under the additional articles. Any revenue loss that is sustained would be minimal and would be compensated by favourable financial, fiscal and economic effects of the rest of the TIEA.

42 Any costs arising to Inland Revenue as a result of the operation of either agreement will be met within existing baselines.

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

43 The Ministry of Foreign Affairs and Trade and the Treasury have been consulted and agree with the proposed treaty action. Further, the concept of TIEAs in general has been canvassed in published policy work programmes.

Subsequent protocols or amendments to the treaty and their likely effects

44 No future amendments are anticipated. New Zealand will consider any proposed amendments to either agreement on a case by case basis, and any decision to accept an amendment would be subject to the usual domestic approvals and procedures.

Withdrawal or denunciation provision in the treaty

45 Article 14 of the TIEA provides that either Party may terminate the TIEA by giving three months' written notice through the diplomatic channel. The Parties will remain bound by the confidentiality provisions contained in article 7 of the TIEA even after it has been terminated.

46 Any decision by New Zealand to terminate either agreement would be subject to the usual domestic approvals and procedures.

Adequacy statement

47 The Inland Revenue Department has prepared this extended national interest analysis and has assessed it as adequate and in accordance with the Code of Good Regulatory Practice.