



**International treaty examination of the Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands on the Exchange of Information with respect to Taxes; the Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments; the Agreement between the Government of New Zealand and the Government of Samoa on the Exchange of Information with respect to Taxes; the Agreement between the Government of New Zealand and the Government of Samoa for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement**

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# Procedure in respect of Transfer Pricing Adjustments; and the Agreement between the Government of New Zealand and the Government of the Republic of Vanuatu on the Exchange of Information with respect to Taxes

Report of the Finance and Expenditure Committee

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**International treaty examination of the Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands on the Exchange of Information with respect to Taxes; the Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments; the Agreement between the Government of New Zealand and the Government of Samoa on the Exchange of Information with respect to Taxes; the Agreement between the Government of New Zealand and the Government of Samoa for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments; and the Agreement between the Government of New Zealand and the Government of the Republic of Vanuatu on the Exchange of Information with respect to Taxes**

### **Recommendation**

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

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We have conducted an international treaty examination of the Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands on the Exchange of Information with respect to Taxes; the Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments; the Agreement between the Government of New Zealand and the Government of Samoa on the Exchange of Information with respect to Taxes; the Agreement between the Government of New Zealand and the Government of Samoa for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments; and the Agreement between the Government of New Zealand and the Government of the Republic of Vanuatu on the Exchange of Information with respect to Taxes.

Tax Information Exchange Agreements are special-purpose bilateral treaties that allow countries to exchange information to assist each other in the enforcement of tax laws on request. Since 2004, New Zealand and Australia have made concerted efforts to conclude a number of tax information exchange agreements with other Pacific jurisdictions. These agreements between New Zealand and the Marshall Islands, Samoa, and Vanuatu reflect the results of this effort.

The information exchange agreements with the Marshall Islands and Samoa are accompanied by agreements on the allocation of taxing rights and transfer pricing adjustments. These supplementary agreements provide specifically for the allocation of taxing rights in a small number of cases, covering students, Government service, and pensions. They also establish a mutual agreement procedure for resolving transfer pricing cases, requiring the two jurisdictions to consult with a view to resolving any issue that may arise.

The tax information exchange agreements are reciprocal, in that they allow each party to the agreements to request information from the other. They do not impose any compliance costs on taxpayers, and will not have any significant fiscal implications for New Zealand. We therefore recommend that the Executive proceed with its proposed treaty action.

The national interest analyses for the agreements are appended to this report.

## Appendix A

### Committee procedure

The committee met on 15 September and 20 October 2010 to consider the agreements. It heard evidence from the Inland Revenue Department.

### Committee members

Craig Foss (Chairperson)

Amy Adams

David Bennett

Hon John Boscawen (until 8 September 2010)

Brendon Burns

Hon David Cunliffe

Hon Sir Roger Douglas (from 8 September 2010)

Aaron Gilmore

Hon Shane Jones

Rahui Katene

Peseta Sam Lotu-Iga

Stuart Nash

Dr Russel Norman

## Appendix B

### **Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands on the Exchange of Information with respect to Taxes**

### **Agreement between the Government of New Zealand and the Government of the Republic of the Marshall Islands for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments**

#### **Executive summary**

1 New Zealand has signed, on 6 August 2010, two tax-related agreements with the Republic of the Marshall Islands (“the Marshall Islands”). The two agreements are the Agreement Between The Government Of New Zealand And The Government Of The Republic Of The Marshall Islands On The Exchange Of Information With Respect To Taxes (“the TIEA”) and the Agreement Between The Government Of New Zealand And The Government Of The Republic Of The Marshall Islands On The Allocation Of Taxing Rights With Respect To Certain Income Of Individuals And To Establish A Mutual Agreement Procedure In Respect Of Transfer Pricing Adjustments (“the Supplementary Agreement”).

2 The TIEA will establish a mechanism by which tax officials from New Zealand and the Marshall Islands (“the Contracting States”) 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. Ready access to this information will enhance the 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 36 exchange of information arrangements in place.

3 The TIEA is based on a model produced by the Organisation for Economic Cooperation and Development (“the OECD”). The TIEA will provide a comprehensive set of rules that support the exchange of information. Information requests can be made only in prescribed circumstances, and information that is received pursuant to a request can be disclosed only to authorised persons and used by those persons only for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the Contracting State to which it is given). The text of the TIEA is attached as Annex I.

4 Although the TIEA will apply on a reciprocal basis, the more limited nature of the Marshall Islands’ tax system means that it will derive lesser benefit from the TIEA whereas New Zealand stands to gain considerable benefit. The Supplementary Agreement was therefore offered by New Zealand to ensure that the Marshall Islands will also receive some benefit from entering into exchange of information arrangements with New Zealand.

The Supplementary Agreement contains articles that will allocate taxing rights in respect of pensions, government service and students, following the approach adopted for such articles in our double tax agreements (“DTAs”). The Supplementary Agreement also includes an article that will establish a “best endeavours” mutual agreement procedure that can be invoked in respect of transfer pricing adjustments. The articles contained in the Supplementary Agreement are not expected to give rise to any significant financial, fiscal or economic costs. The text of the Supplementary Agreement is attached as Annex II.

5 A second key measure offered by New Zealand as encouragement to the Marshall Islands to enter into the TIEA is Article 11 of the TIEA. This article will establish an obligation for the Contracting States not to impose “prejudicial or restrictive measures based on harmful tax practices” on each other. Given that the TIEA with the Marshall Islands will provide for full exchange of information on tax matters, it would be inappropriate for New Zealand to impose any such measures on the Marshall Islands while the TIEA is in force. The provision was included in recognition of this, but was expressed as a reciprocal obligation on both Contracting States.

#### **Nature and timing of proposed binding treaty action**

6 Subsequent to satisfactory completion of the Parliamentary treaty examination process, the TIEA and the Supplementary Agreement can be incorporated into domestic legislation by Order(s) in Council pursuant to section BH 1 of the Income Tax Act 2007. The making of the Order(s) in Council is envisaged to be completed by the end of this year.

7 Upon the promulgation of the Order(s) in Council, each agreement can then be brought into force through an exchange of diplomatic notes that confirms the completion of the respective constitutional and legal requirements for entry into force by each Contracting State (Article 13 of the TIEA and Article 10 of the Supplementary Agreement). New Zealand officials will manage the process to ensure that both agreements enter into force on the same date. Upon entry into force, the TIEA will apply prospectively to all taxable periods beginning on or after 1 January following entry into force (or, where there is no taxable period, to all charges to tax arising on or after 1 January following entry into force). The Supplementary Agreement will apply, in New Zealand, to income years beginning on or after 1 April following the date of entry into force.

8 No consultation with the Cook Islands, Niue or Tokelau is required. The agreements will not apply to these states. (The agreements apply only for the purposes of New Zealand and Marshall Islands taxes. New Zealand tax laws do not apply to the Cook Islands, Niue or Tokelau.)

#### **Reasons for New Zealand to become a Party to the treaty**

##### **The TIEA**

9 New Zealand domestic law specifically prohibits Inland Revenue from divulging information it holds to foreign jurisdictions, except when authorised by a tax treaty.<sup>1</sup> Other countries generally follow the same principle. Therefore, to assist in the detection and

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<sup>1</sup> Refer to Sections 81 and 88 of Tax Administration Act 1994. The term “double tax agreement”, as used in section 88, is (by virtue of its legislative definition) also applicable to TIEAs.

prevention of tax avoidance and tax evasion, most developed countries are building networks of TIEAs that allow for the exchange of information on tax matters.

10 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 concluded between trading and investment partners with broadly similar tax systems. To cater for other situations, the OECD 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 establish information sharing arrangements.<sup>2</sup> The list includes the Marshall Islands. New Zealand has, to date, signed 15 TIEAs with jurisdictions included on the 2000 list.

11 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.

12 The TIEA with the Marshall Islands will provide 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, will also ensure that information is not requested or used indiscriminately. Requested information must be "foreseeably relevant" to the tax affairs of a particular person or entity. (The commentary to the OECD model TIEA clarifies that this means that the Contracting States are not at liberty to engage in "fishing expeditions".) In addition, information received pursuant to a request may be disclosed only to authorised persons and may be used by those persons only for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the respective Contracting State.)

13 Interference from bank secrecy and domestic tax interest rules is specifically prohibited as an obstacle to effective information exchange.<sup>3</sup> Otherwise, rights and safeguards secured to residents of either jurisdiction by domestic law or administrative practice will remain in effect. (Thus, for example, information protected by legal professional privilege will not be required to be provided.) As noted above, the Contracting States will be required to maintain strict confidentiality in relation to any information received pursuant to a request.

14 The text of the TIEA is attached as Annex I.

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<sup>2</sup> The 2000 OECD report "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices".

<sup>3</sup> 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.



### The Supplementary Agreement

15 Although the TIEA will apply on a reciprocal basis, the Marshall Islands has a more limited tax system than New Zealand.<sup>4</sup> The Marshall Islands will therefore have less need to request information on tax matters from offshore than will New Zealand. Accordingly, New Zealand has a greater interest in concluding a TIEA than the Marshall Islands, and can expect to derive greater benefits from the TIEA than will the Marshall Islands.

16 To redress this imbalance, New Zealand offered the Marshall Islands a Supplementary Agreement. The Supplementary Agreement contains articles that will allocate taxing rights in respect of pensions, government service and students, and that will establish a mutual agreement procedure that can be invoked in respect of transfer pricing adjustments.<sup>5</sup>

17 New Zealand generally enters into provisions for the allocation of taxing rights only 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).

18 Full reciprocity of this type is unlikely to occur in relation to the Marshall Islands. For this reason, New Zealand proposed a Supplementary Agreement that contains a limited selection of DTA articles. The articles chosen do not give rise to any significant financial, fiscal or economic costs for New Zealand. Nor will they provide a commercial advantage to individuals or entities operating in the Marshall Islands. The Supplementary Agreement with the Marshall Islands will give rise to the following:

- Pursuant to Article 5 of the Supplementary Agreement, pensions paid to an individual will be taxable only in the jurisdiction of which that individual is a tax resident. This will mean, for example, that the Marshall Islands will gain a sole taxing right over the pension of any New Zealander who retires to the Marshall Islands. (However, the pension must actually be subject to income tax in the Marshall Islands for the article to apply. Therefore, there will be no incentive for New Zealanders to seek to retire to the Marshall Islands in order to obtain a tax exemption.)
- Pursuant to Article 6 of the Supplementary Agreement, 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. The rule is formulated in a way designed to ensure that it will only apply when a Marshall Islands' 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 92 days.

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<sup>4</sup> The Marshall Islands, unlike many of the other jurisdictions with which we are concluding TIEAs, does tax the worldwide income of its residents. However, the concept of "residence" for tax purposes is more limited than is the case in New Zealand. In addition, The Marshall Islands tax law does not have many elements that are typical of developed country tax systems, such as Controlled Foreign Company legislation.

<sup>5</sup> 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 7 of the Supplementary Agreement, 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 8 of the Supplementary Agreement, 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 Supplementary Agreement provides that the Contracting States 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 DTAs.)

19 Article 9 of the Supplementary Agreement provides that information may be exchanged for the purposes of carrying out the provisions of the Supplementary Agreement using the mechanism established by the TIEA. This is an important clarification to ensure that, if the respective tax authorities need to communicate with each other for the purpose of applying the Supplementary Agreement, they can do so without violating the domestic secrecy laws that otherwise protect tax matters.

20 Given that the Supplementary Agreement has been negotiated primarily for the purposes of securing and supporting the TIEA, Article 10 of the Supplementary Agreement explicitly provides that the provisions of the Supplementary Agreement will have effect only while the TIEA is in force.

21 New Zealand will not itself gain any direct benefit from entering into the Supplementary Agreement. The Supplementary Agreement, however, supports both the conclusion of the TIEA and relations between the Contracting States, and New Zealand will therefore benefit indirectly.

22 The text of the Supplementary Agreement is attached as Annex II.

### **The Understanding on Costs**

23 The TIEA and Supplementary Agreement will be supported by a less-than-treaty-status instrument. The instrument is an Understanding between the New Zealand Inland Revenue Department and the Marshall Islands' Revenue and Taxation Office that sets out the shared understanding of the respective competent authorities on matters of liability for costs of obtaining and providing information in response to a request under the TIEA.

24 The less-than-treaty-status Understanding will not create legally binding commitments for New Zealand. It is therefore not required to undergo treaty examination. It will be entered into by the New Zealand Inland Revenue Department and the Marshall Islands Revenue and Taxation Office prior to entry into force of the TIEA.

**Consideration of Other Options**

25 New Zealand's objective in negotiations was to secure effective exchange of information arrangements with the Marshall Islands. The only other possible treaty mechanism for entering into such arrangements with the Marshall Islands would be as part of a DTA. However, DTAs are designed to be concluded between trading and investment partners with broadly similar tax systems. In addition, New Zealand's DTA negotiation work programme is currently committed to renegotiating existing, older DTAs, and it would not be possible to give the negotiation of a DTA with the Marshall Islands any priority in the short-to-medium term.

26 Over the past year, there has been increased international pressure on international finance centres, such as the Marshall Islands, to enter into effective exchange of information arrangements with OECD member countries. This increased pressure makes it arguable that benefits such as a Supplementary Agreement no longer need to feature in TIEA negotiations. However, the offer of benefits was made to the Marshall Islands before the developments that resulted in increased international pressure. New Zealand's approach is also consistent with that of Australia (which signed a TIEA and Supplementary Agreement with the Marshall Islands on 12 May 2010).

**Advantages and Disadvantages to New Zealand of the Treaty entering into Force**

27 The Marshall Islands is an international finance centre, and many New Zealanders have dealings through legal entities established in the Marshall Islands to take advantage of low rates of tax. The TIEA will enable New Zealand tax officials to request tax records, business books and accounts, bank information, and ownership information from the Marshall Islands in respect of such dealings. Access to this information will enhance the New Zealand Inland Revenue Department's ability to detect and prevent tax avoidance and tax evasion. (The TIEA will permit New Zealand to request information in relation to "taxes of every kind and description". Its principal application, however, will likely 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.

28 The Marshall Islands is unlikely to raise many requests for information from New Zealand. If requests for information are received from the Marshall Islands, 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 the Marshall Islands will therefore 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 costs that may arise.

29 New Zealand may be required to bear some costs in relation to requests for information that it makes to the Marshall Islands. The less-than-treaty-status Understanding referred to above sets out the shared understanding of the Contracting States with respect to costs, as is required by Article 9 of the TIEA. "Ordinary" costs of complying with a request will be borne by the requested Contracting State, but "extraordinary costs" (such as the cost of hiring translators or interpreters) will be

reimbursed by the requesting Contracting State. However, prior consultation will be required if extraordinary costs appear likely to exceed US\$1000. This will ensure that New Zealand will progress information requests giving rise to significant reimbursement costs only if the need to obtain the information justifies the expenditure.<sup>6</sup>

30 The Supplementary Agreement was negotiated primarily for the purpose of securing a TIEA with the Marshall Islands. New Zealand is not expected to derive any direct benefit from the Supplementary Agreement. The Supplementary Agreement, however, supports the conclusion of the TIEA and will indirectly benefit New Zealand by means of the TIEA and relations generally. As noted above, the Supplementary Agreement is not expected to give rise to any significant negative financial, fiscal or economic implications. Any costs that do arise will be outweighed by the benefits New Zealand stands to gain from concluding the TIEA.

31 The TIEA contains one article, Article 11, not found in the OECD model TIEA. This article constitutes the second key element of the New Zealand benefits package. Article 11 imposes an obligation on the Contracting States 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 imposing coordinated sanctions on or taking other defensive measures against jurisdictions for refusing to exchange information on tax matters has been raised.<sup>7</sup> Given that the TIEA with the Marshall Islands provides for full exchange of information on tax matters, it would be inappropriate for New Zealand to impose any such measures on the Marshall Islands while the TIEA is in force. The provision was included in recognition of this, but was expressed as a reciprocal obligation on both Contracting States.

32 The conclusion of the TIEA with the Marshall Islands will also enable New Zealand to list the Marshall Islands as an approved territory for the purposes of the venture capital exemption at section CW 12 of the Income Tax Act 2007. The purpose of the section CW 12 exemption is to facilitate increased venture capital into New Zealand. It does this by exempting qualifying foreign investors from approved territories from paying income tax on any gains derived from the sale of shares in qualifying venture capital investments. Under existing policy, it is possible to approve territories for the purposes of the section CW 12 exemption only when effective exchange of information arrangements are in place.

33 On balance, it is in New Zealand’s interests to conclude the TIEA and the Supplementary Agreement with the Marshall Islands.

34 If the Marshall Islands ever unilaterally terminates the TIEA, the Supplementary Agreement will cease to apply. (Given that sole purpose of the Supplementary Agreement

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<sup>6</sup> In recognition of the possibility that capacity issues in the Marshall Islands may mean that, on occasion, 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 may consult in such circumstances with a view to finding solutions. For example, where it is important for Inland Revenue to obtain the information, New Zealand may agree to pay a larger share of the costs.

<sup>7</sup> Refer to 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”. 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”.

is to support the conclusion of the TIEA, Article 10 of the Supplementary Agreement clarifies that it shall have effect only when a TIEA is in force between the Contracting States.) Similarly, if New Zealand ever unilaterally terminates the Supplementary Agreement, the Marshall Islands could be expected to terminate the TIEA.

## **Obligations**

### **The TIEA**

35 The TIEA will impose a reciprocal obligation for each Contracting State to provide, upon request, information that is foreseeably relevant to the administration and enforcement of specified taxes. In the case of the Marshall Islands, the specified taxes are “taxes of every kind and description” (see Article 2(1)(a)). As noted above, the Marshall Islands is unlikely to make many requests for information from New Zealand.

36 The Contracting States will be required to maintain strict confidentiality in relation to any information received pursuant to a request. Such information may be disclosed only to authorised persons and may be used only for specified purposes (principally the administration and enforcement of the domestic tax laws of the respective Contracting State), (see Article 8).

37 In the Understanding, the respective tax authorities set out their shared understanding of how incidence of costs incurred in providing assistance will be addressed. The requesting Contracting State is to reimburse the requested Contracting State 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 Contracting State. Prior consultation will be required if extraordinary costs appear likely to exceed US\$1000.

38 Both Contracting States will be constrained from imposing “prejudicial or restrictive measures based on harmful tax practices” (see Article 11). New Zealand does not currently impose any such measures and, given that the TIEA provides for full exchange of information on tax matters with the Marshall Islands, New Zealand would not contemplate introducing such measures with respect to the Marshall Islands while the TIEA is in force.

39 Reservations are not provided for under the TIEA.

40 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 an authorised representative; for the Marshall Islands, the Minister of Revenue or an authorised representative of the Minister of Revenue). The Contracting States may also decide upon other forms of dispute resolution (see Article 12).

### **The Supplementary Agreement**

41 The Supplementary Agreement will impose obligations on New Zealand to limit its taxing rights in certain limited circumstances (in respect of pensions, government service and students). For reasons detailed at paragraph 18 above, the practical implications for New Zealand are likely to be minimal.

- In respect of pensions, New Zealand will be unable to tax a pension paid from New Zealand to a recipient who is a tax resident of the Marshall Islands. (This obligation applies only if the pension is subject to income tax in the Marshall Islands. See Article 5.)
- In respect of remuneration for government service, New Zealand will be unable to tax payments made by the Government of the Marshall Islands to an individual in respect of services rendered to that Government. The rule, as formulated, will apply only when a Marshall Islands' Government official comes to New Zealand in an official capacity (see Article 6).
- In respect of students and business apprentices, New Zealand will be unable to tax payments received from outside New Zealand for the purposes of a student or apprentice's maintenance, education or training (see Article 7).
- In respect of transfer pricing adjustments, the New Zealand Inland Revenue Department may be required to enter into consultations with the Marshall Islands' Ministry of Revenue if a taxpayer affected by the adjustment invokes the mutual agreement procedure (see Article 8).

42 Reservations are not provided for under the Supplementary Agreement.

### Implementation

43 Subject to the successful completion of the Parliamentary treaty examination process, the TIEA and the Supplementary Agreement will be implemented into New Zealand domestic law by Order(s) 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(s) in Council.<sup>8</sup> 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. Therefore, the TIEA falls within the ambit of section BH 1. Relief from double taxation and relief from tax are also listed purposes. Therefore the Supplementary Agreement also falls within the ambit of section BH 1.

44 Upon completion of the Parliamentary treaty examination process, officials will arrange for Order(s) in Council to be made and for the other steps for entry into force to be undertaken. This includes New Zealand notifying the Marshall Islands by diplomatic note that all of its domestic constitutional and legal procedures for entry into force of the TIEA are complete. The Marshall Islands will likewise notify New Zealand when its own procedures are complete. It is expected that this process will be completed before the end of 2010.

45 There are no other viable regulatory options for implementing the obligations in the agreements.

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<sup>8</sup> That is, the Order(s) 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 for these Acts.

**Economic, Social, Cultural and Environmental Costs and Effects of the Treaty Action**

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

**Costs to New Zealand of Compliance with the Agreements**

47 New Zealand will be required to reimburse the Marshall Islands 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 progress information requests giving rise to significant reimbursement costs only if the need to obtain the information justifies the expenditure.

48 New Zealand is likely to raise more requests for information than the Marshall Islands but, if requests for information are received from the Marshall Islands, New Zealand will incur administrative costs in complying with those information requests. As noted above, 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 the Marshall Islands are therefore expected to be marginal.

49 The allocation of taxing rights under the Supplementary Agreement will result in some revenue cost. However, as noted in paragraph 18 above, this is not expected to be significant. Any revenue loss that is sustained will be compensated by favourable financial, fiscal and economic effects of the TIEA.

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

**Consultation**

51 The Ministry of Foreign Affairs and Trade and the Treasury have been consulted and agree with the proposed treaty action. (They did not raise any concerns with this national interest analysis.) Further, the concept of TIEAs in general has been canvassed in the government's published policy work programmes.

**Future Protocols**

52 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**

53 Article 14 of the TIEA provides that either Contracting State may terminate the TIEA by giving six months' notice, in writing, through the diplomatic channel. The Contracting States will remain bound by the confidentiality provisions contained in Article 8 of the TIEA even after it has been terminated.

54 Article 11 of the Supplementary Agreement provides that either Contracting State may terminate the Supplementary Agreement by giving written notice through the diplomatic

channel. Such termination will become effective, for New Zealand, in the income year beginning on or after 1 April in the calendar year next following that in which the notice of termination is given. For the Marshall Islands, the termination will become effective in the income year beginning on or after 1 October in the calendar year next following that in which the notice of termination is given.

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

#### **Agency Disclosure Statement**

56 Inland Revenue has prepared this extended national interest analysis. It has undertaken an analysis of the issue of implementing a TIEA and a Supplementary Agreement between New Zealand and the Marshall Islands and the legislative and regulatory proposals arising from that implementation. It has considered all other relevant options in that process. Inland Revenue is of the view that there are no significant constraints, caveats or uncertainties concerning the regulatory analysis.

57 An Order in Council is required to implement the TIEA and the Supplementary Agreement into New Zealand domestic law.

58 Inland Revenue is of the view that the policy options considered will not impose additional costs on businesses; impair private property rights or market competition; adversely impact the incentives on businesses to innovate and invest; or override fundamental common principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).

59 Inland Revenue notes that the form of this TIEA and national interest analysis is consistent with that of a number of previous TIEAs and national interest analyses prepared in relation to other TIEAs concluded by New Zealand. The conclusion of a Supplementary Agreement in support of the TIEA is consistent with the approach adopted with previous TIEAs that New Zealand has signed and the terms of the Supplementary Agreement largely duplicate those in existing treaties.



## Appendix C

### **Agreement between the Government of New Zealand and the Government of Samoa on the Exchange of Information with respect to Taxes**

### **Agreement between the Government of New Zealand and the Government of Samoa for the Allocation of Taxing Rights with respect to Certain Income of Individuals and to Establish a Mutual Agreement Procedure in respect of Transfer Pricing Adjustments**

#### **Executive Summary**

1 New Zealand has signed, on 24 August 2010, two tax-related agreements with Samoa. The two agreements are the Agreement Between The Government Of New Zealand And The Government Of Samoa On The Exchange Of Information With Respect To Taxes (“the TIEA”) and the Agreement Between The Government Of New Zealand And The Government Of Samoa On The Allocation Of Taxing Rights With Respect To Certain Income Of Individuals And To Establish A Mutual Agreement Procedure In Respect Of Transfer Pricing Adjustments (“the Supplementary Agreement”).

2 The TIEA will establish a mechanism by which tax officials from New Zealand and Samoa (“the Contracting States”) 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 the 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 36 exchange of information arrangements in place.

3 The TIEA is based on a model produced by the Organisation for Economic Cooperation and Development (“the OECD”). The TIEA will provide a comprehensive set of rules that support the exchange of information. Information requests can be made only in prescribed circumstances, and information that is received pursuant to a request can be disclosed only to authorised persons and used by those persons only for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the Contracting State to which it is given). The text of the TIEA is attached as Annex A.

4 Although the TIEA will apply on a reciprocal basis, the more limited nature of Samoa’s tax system means that it will derive little benefit from the TIEA whereas New Zealand stands to gain considerable benefit. The Supplementary Agreement was therefore offered by New Zealand to ensure that Samoa will also receive some benefit from entering into exchange of information arrangements with New Zealand. The Supplementary Agreement contains articles that will allocate taxing rights in respect of pensions, government service and students, following the approach adopted for such articles in our DTAs. The Supplementary Agreement also includes an article that will establish a “best endeavours”

mutual agreement procedure that can be invoked in respect of transfer pricing adjustments. The articles contained in the Supplementary Agreement are not expected to give rise to any significant financial, fiscal or economic costs. The text of the Supplementary Agreement is attached as Annex B.

5 A second key measure offered by New Zealand as encouragement to Samoa to enter into the TIEA is Article 11 of the TIEA. This article will establish an obligation on the Contracting States not to impose “prejudicial or restrictive measures based on harmful tax practices” on each other. Given that the TIEA with Samoa will provide for full exchange of information on tax matters, it would be inappropriate for New Zealand to impose any such measures on Samoa while the TIEA is in force. The provision was included in recognition of this, but was expressed as a reciprocal obligation on both Contracting States.

#### **Date and nature of proposed binding treaty action**

6 Subsequent to satisfactory completion of the Parliamentary treaty examination process, the TIEA and the Supplementary Agreement can be incorporated into domestic legislation by Order(s) in Council pursuant to section BH 1 of the Income Tax Act 2007. The making of the Order(s) in Council is envisaged to be completed by the end of this year.

7 Upon the promulgation of the Order(s) in Council, the agreements can then each be brought into force through an exchange of diplomatic notes that confirms the completion of the respective constitutional and legal requirements for entry into force by each Contracting State (Article 13 of the TIEA and Article 10 of the Supplementary Agreement). New Zealand officials will manage the process to ensure that both agreements enter into force on the same date. Upon entry into force, the TIEA will apply prospectively to all taxable periods beginning on or after 1 January following entry into force (or, where there is no taxable period, to all charges to tax arising on or after 1 January following entry into force). The Supplementary Agreement will apply, in New Zealand, to income years beginning on or after 1 April following the date of entry into force.

8 No consultation with the Cook Islands, Niue or Tokelau is required. The agreements will not apply to these states. (The agreements apply only for the purposes of New Zealand and Samoan taxes. New Zealand tax laws do not apply to the Cook Islands, Niue or Tokelau.)

#### **Reasons for New Zealand to become a Party to the Treaty**

##### **The TIEA**

9 New Zealand domestic law specifically prohibits Inland Revenue from divulging information it holds to foreign jurisdictions, except when authorised by a tax treaty.<sup>1</sup> 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 TIEAs that allow for the exchange of information on tax matters.

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<sup>1</sup> Sections 81 and 88 of Tax Administration Act 1994 refer. The term “double tax agreement”, as used in section 88, is (by virtue of its legislative definition) also applicable to TIEAs.

10 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 concluded between trading and investment partners with broadly similar tax systems. To cater for other situations, the OECD 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 establish information sharing arrangements.<sup>2</sup> The 2000 list includes Samoa. New Zealand has, to date, signed 15 TIEAs with jurisdictions included on the 2000 list. The TIEA with Samoa will be our 16th.

11 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.

12 The TIEA with Samoa will provide 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, will also ensure that information is not requested or used indiscriminately. Requested information must be "foreseeably relevant" to the tax affairs of a particular person or entity. (The commentary to the OECD model TIEA clarifies that this means that the Contracting States are not at liberty to engage in "fishing expeditions".) In addition, information received pursuant to a request may be disclosed only to authorised persons and may be used by those persons only for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the respective Contracting State.)

13 Interference from bank secrecy and domestic tax interest rules is specifically prohibited as an obstacle to effective information exchange.<sup>3</sup> Otherwise, rights and safeguards secured to residents of either jurisdiction by domestic law or administrative practice will remain in effect. (Thus, for example, information protected by legal professional privilege will not be required to be provided.) As noted above, the Contracting States will be required to maintain strict confidentiality in relation to any information received pursuant to a request.

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

### **The Supplementary Agreement**

15 Although the TIEA will apply on a reciprocal basis, Samoa has a more limited tax system than New Zealand.<sup>4</sup> Samoa will therefore have less need to request information on

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<sup>2</sup> The 2000 OECD report "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices" refers.

<sup>3</sup> 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.

<sup>4</sup> Samoa, unlike many of the other jurisdictions with which we are concluding TIEAs, does tax the worldwide income of its residents. However, the concept of "residence" for tax purposes is more limited than is the case in New Zealand. In

tax matters from offshore than will New Zealand. Accordingly, New Zealand has a greater interest in concluding a TIEA than Samoa, and can expect to derive greater benefits from the TIEA than will Samoa.

16 To redress this imbalance, New Zealand offered Samoa a Supplementary Agreement. The Supplementary Agreement contains articles that will allocate taxing rights in respect of pensions, government service and students and that will establish a mutual agreement procedure that can be invoked in respect of transfer pricing adjustments.<sup>5</sup>

17 New Zealand generally enters into provisions for the allocation of taxing rights only 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).

18 Full reciprocity of this type is unlikely to occur in relation to Samoa. For this reason, New Zealand proposed a Supplementary Agreement that contains a limited selection of DTA articles. The articles chosen do not give rise to any significant financial, fiscal or economic costs for New Zealand. Nor will they provide a commercial advantage to individuals or entities operating in Samoa. The Supplementary Agreement with Samoa will give rise to the following:

- Pursuant to Article 5 of the Supplementary Agreement, pensions paid to an individual will be taxable only in the jurisdiction of which that individual is a tax resident. This will mean, for example, that Samoa will gain a sole taxing right over the pension of any New Zealander who retires to Samoa. (However, the pension must actually be subject to income tax in Samoa for the article to apply. Therefore, there will be no incentive for New Zealanders to seek to retire to Samoa in order to obtain a tax exemption.)
- Pursuant to Article 6 of the Supplementary Agreement, 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. The rule is formulated in a way designed to ensure that it will only apply when a Samoan 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 92 days.

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addition, Samoan tax law does not have many elements that are typical of developed country tax systems, such as Controlled Foreign Company legislation.

<sup>5</sup> 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 7 of the Supplementary Agreement, 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 8 of the Supplementary Agreement, 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 Supplementary Agreement provides that the Contracting States 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 DTAs.)

19 Article 9 of the Supplementary Agreement provides that information may be exchanged for the purposes of carrying out the provisions of the Supplementary Agreement using the mechanism established by the TIEA. This is an important clarification to ensure that if the respective tax authorities need to communicate with each other for the purpose of applying the Supplementary Agreement, they can do so without violating their domestic secrecy laws that otherwise protect tax matters.

20 Given that the Supplementary Agreement has been negotiated primarily for the purposes of securing and supporting the TIEA, Article 10 of the Supplementary Agreement explicitly provides that the provisions of the Supplementary Agreement will have effect only while the TIEA is in force.

21 New Zealand will not itself gain any direct benefit from entering into the Supplementary Agreement. The Supplementary Agreement, however, supports both the conclusion of the TIEA and relations between the Contracting States, and New Zealand will therefore benefit indirectly.

22 The text of the Supplementary Agreement is attached as Annex B.

### **The Understanding**

23 The TIEA and Supplementary Agreement will be supported by a less-than-treaty status instrument. The instrument is an Understanding between the New Zealand Inland Revenue Department and the Samoan Ministry of Revenue that sets out the shared understanding of the respective competent authorities on matters of liability for costs of obtaining and providing information in response to a request under the TIEA.

24 The less-than-treaty status Understanding will not create legally binding commitments for New Zealand. It is therefore not required to undergo treaty examination. It will be entered into by the New Zealand Inland Revenue and Samoa's Ministry of Revenue prior to entry into force of the TIEA.

**Consideration of other options**

25 New Zealand's objective in negotiations was to secure effective exchange of information arrangements with Samoa. The only other possible treaty mechanism for entering into such arrangements with Samoa would be as part of a DTA. However, DTAs are designed to be concluded between trading and investment partners with broadly similar tax systems. In addition, New Zealand's DTA negotiation work programme is currently committed to renegotiating existing, older DTAs, and it would not be possible to give the negotiation of a DTA with Samoa any priority in the short-to-medium term.

26 Over the past year, there has been increased international pressure on international finance centres, such as Samoa, to enter into effective exchange of information arrangements with OECD member countries. This increased pressure makes it arguable that New Zealand did not need to offer Samoa a Supplementary Agreement. However, New Zealand has a very close relationship with Samoa, and it is appropriate to ensure that both sides derive benefit from the information-sharing arrangement. New Zealand's approach is also consistent with that of other OECD member countries, particularly that of Australia.

**Advantages and disadvantages to New Zealand of the Treaty entering into Force**

27 Samoa is an international finance centre, and many New Zealanders have dealings through legal entities established in Samoa to take advantage of low rates of tax. The TIEA will enable New Zealand tax officials to request tax records, business books and accounts, bank information, and ownership information from Samoa in respect of such dealings. Access to this information will enhance the New Zealand Inland Revenue Department's ability to detect and prevent tax avoidance and tax evasion. (The TIEA will permit New Zealand to request information in relation to "taxes of every kind and description". Its principal application, however, will likely 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.

28 Samoa is unlikely to raise many requests for information from New Zealand. If requests for information are received from Samoa, 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 Samoa will therefore 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.

29 New Zealand may be required to bear some costs in relation to requests for information that it makes to Samoa. The less-than-treaty status Understanding referred to above sets out the shared understanding of the Contracting States with respect to costs, as is required by Article 9 of the TIEA. "Ordinary" costs of complying with a request will be borne by the requested Contracting State, but "extraordinary costs" (such as the cost of hiring translators or interpreters) will be reimbursed by the requesting Contracting State. However, prior consultation will be required if extraordinary costs appear likely to exceed NZ\$1000. This will ensure that New Zealand will progress information requests giving rise

to significant reimbursement costs only if the need to obtain the information justifies the expenditure.<sup>6</sup>

30 The Supplementary Agreement was negotiated primarily for the purpose of securing a TIEA with Samoa. New Zealand is not expected to derive any direct benefit from the Supplementary Agreement. The Supplementary Agreement, however, supports the conclusion of the TIEA and will indirectly benefit New Zealand by means of the TIEA and relations generally. As noted above, the Supplementary Agreement is not expected to give rise to any significant negative financial, fiscal or economic implications. Any costs that do arise will be outweighed by the benefits New Zealand stands to gain from concluding the TIEA.

31 The TIEA contains one article, Article 11, not found in the OECD model TIEA. This article constitutes the second key element of the New Zealand benefits package. Article 11 imposes an obligation on the Contracting States 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 imposing coordinated sanctions on or taking other defensive measures against jurisdictions for refusing to exchange information on tax matters has been raised.<sup>7</sup> Given that the TIEA with Samoa provides for full exchange of information on tax matters, it would be inappropriate for New Zealand to impose any such measures on Samoa while the TIEA is in force. The provision was included in recognition of this, but was expressed as a reciprocal obligation on both Contracting States.

32 The conclusion of the TIEA with Samoa will also enable New Zealand to list Samoa as an approved territory for the purposes of the venture capital exemption at section CW 12 of the Income Tax Act 2007. The purpose of the section CW 12 exemption is to facilitate increased venture capital into New Zealand. It does this by exempting qualifying foreign investors from approved territories from paying income tax on any gains derived from the sale of shares in qualifying venture capital investments. Under existing policy, it is possible to approve territories for the purposes of the section CW 12 exemption only when effective exchange of information arrangements are in place.

33 On balance, it is in New Zealand’s interests to conclude the TIEA and the Supplementary Agreement with Samoa.

34 If Samoa ever unilaterally terminates the TIEA, the Supplementary Agreement will cease to apply. (Given that sole purpose of the Supplementary Agreement is to support the conclusion of the TIEA, Article 10 of the Supplementary Agreement clarifies that it shall have effect only when a TIEA is in force between the Contracting States.) Similarly, if

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<sup>6</sup> In recognition of the possibility that capacity issues in Samoa 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 may consult in such circumstances with a view to finding solutions. For 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.

<sup>7</sup> 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”.

New Zealand ever unilaterally terminates the Supplementary Agreement, Samoa could be expected to terminate the TIEA.

## **Obligations**

### **The TIEA**

35 The TIEA will impose a reciprocal obligation on each Contracting State to provide, upon request, information that is foreseeably relevant to the administration and enforcement of specified taxes. In the case of Samoa, the specified taxes are “taxes of every kind and description”. Article 2(1)(a) refers. As noted above, Samoa is unlikely to make many requests for information from New Zealand.

36 The Contracting States will be required to maintain strict confidentiality in relation to any information received pursuant to a request. Such information may be disclosed only to authorised persons and may be used only for specified purposes (principally the administration and enforcement of the domestic tax laws of the respective Contracting State). Article 8 refers.

37 In the Understanding, the respective tax authorities set out their shared understanding of how incidence of costs incurred in providing assistance will be addressed. The requesting Contracting State is to reimburse the requested Contracting State 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 Contracting State. Prior consultation will be required if extraordinary costs appear likely to exceed NZ\$1000.

38 Both Contracting States will be constrained from imposing “prejudicial or restrictive measures based on harmful tax practices”. Article 11 refers. New Zealand does not currently impose any such measures and, given that the TIEA provides for full exchange of information on tax matters with Samoa, New Zealand would not contemplate introducing such measures with respect to Samoa while the TIEA is in force.

39 Reservations are not provided for under the TIEA.

40 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 an authorised representative; for Samoa, the Minister of Revenue or an authorised representative of the Minister of Revenue). The Contracting States may also decide upon other forms of dispute resolution. Article 12 refers.

### **The Supplementary Agreement**

41 The Supplementary Agreement will impose obligations on New Zealand to limit its taxing rights in certain limited circumstances (in respect of pensions, government service and students). For reasons detailed at paragraph 18 above, the practical implications for New Zealand are likely to be minimal.

- In respect of pensions, New Zealand will be unable to tax a pension paid from New Zealand to a recipient who is a tax resident of Samoa. (This obligation applies only if the pension is subject to income tax in Samoa.) Article 5 refers.



- In respect of remuneration for government service, New Zealand will be unable to tax payments made by the Government of Samoa to an individual in respect of services rendered to that Government. The rule, as formulated, will apply only when a Samoan Government official comes to New Zealand in an official capacity. Article 6 refers.
- In respect of students and business apprentices, New Zealand will be unable to tax payments received from outside New Zealand for the purposes of a student or apprentice's maintenance, education or training. Article 7 refers.
- In respect of transfer pricing adjustments, the New Zealand Inland Revenue may be required to enter into consultations with Samoa's Ministry of Revenue if a taxpayer affected by the adjustment invokes the mutual agreement procedure. Article 8 refers.

42 Reservations are not provided for under the Supplementary Agreement.

### **Implementation**

43 Subject to the successful completion of the Parliamentary treaty examination process, the TIEA and the Supplementary Agreement will be implemented into New Zealand domestic law by Order 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.<sup>8</sup> 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. Therefore, the TIEA falls within the ambit of section BH 1. Relief from double taxation and relief from tax are also listed purposes. Therefore the Supplementary Agreement also falls within the ambit of section BH 1.

44 Upon signing, officials will arrange for an Order in Council to be made and for the other steps for entry into force to be undertaken. It is expected that this process will be completed before the end of the year.

45 There are no other viable regulatory options for implementing the obligations in the agreements.

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

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

### **Costs to New Zealand of compliance with the agreements**

47 New Zealand will be required to reimburse Samoa 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 NZ\$1000. This will ensure that New Zealand will progress

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<sup>8</sup> 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.

information requests giving rise to significant reimbursement costs only if the need to obtain the information justifies the expenditure.

48 New Zealand is likely to raise more requests for information than Samoa but, if requests for information are received from Samoa, New Zealand will incur administrative costs in complying with those information requests. As noted above, 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 Samoa are therefore expected to be marginal.

49 The allocation of taxing rights under the Supplementary Agreement will result in some revenue cost. However, as noted in paragraph 20 above, this is not expected to be significant. Any revenue loss that is sustained will be compensated by favourable financial, fiscal and economic effects of the TIEA.

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

#### **Consultation**

51 The Ministry of Foreign Affairs and Trade and the Treasury have been consulted and agree with the proposed treaty action. (They did not raise any concerns with this NIA.) Further, the concept of TIEAs in general has been canvassed in Inland Revenue's published policy work programmes.

#### **Future Protocols**

52 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**

53 Article 14 of the TIEA provides that either Contracting State may terminate the TIEA by giving six months' written notice through the diplomatic channel. The Contracting States will remain bound by the confidentiality provisions contained in Article 8 of the TIEA even after it has been terminated.

54 Article 11 of the Supplementary Agreement provides that either Contracting State may terminate the Supplementary Agreement by giving written notice through the diplomatic channel. Such termination will become effective, for New Zealand, in the income year beginning on or after 1 April in the calendar year next following that in which the notice of termination is given. For Samoa, the termination will become effective in the income year beginning on or after 1 January in the calendar year next following that in which the notice of termination is given.

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

**Agency disclosure statement**

56 The Inland Revenue Department has prepared this extended national interest analysis. It has undertaken an analysis of the issue of implementing a TIEA and a Supplementary Agreement between New Zealand and Samoa and the legislative and regulatory proposals arising from that implementation. It has considered all other possible options in that process. Inland Revenue is of the view that there are no significant constraints, caveats or uncertainties concerning the regulatory analysis.

57 An Order in Council is required to implement the TIEA and the Supplementary Agreement into New Zealand domestic law.

58 Inland Revenue is of the opinion that the policy options considered will not impose additional costs on businesses; impair private property rights, restrict market competition; adversely impact the incentives on businesses to innovate and invest; or override fundamental common principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).

59 Inland Revenue notes that the form of this TIEA and National Interest Analysis is consistent with that of a number of previous TIEAs and National Interest Analyses prepared in relation to other TIEAs concluded by New Zealand. The conclusion of a Supplementary Agreement in support of the TIEA is consistent with the approach adopted with previous TIEAs that New Zealand has signed and the terms of the Supplementary Agreement largely duplicate those in existing treaties.

## Appendix D

### **Agreement between the Government of New Zealand and the Government of the Republic of Vanuatu on the Exchange of Information with respect to Taxes**

#### **Executive Summary**

1 On 4 August 2010, New Zealand signed the Agreement between the Government of New Zealand and the Government of the Republic of Vanuatu on the Exchange of Information with Respect to Taxes (“the TIEA”).

2 The TIEA will establish a mechanism by which tax officials from New Zealand and Vanuatu (“the Contracting 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. Ready access to this information will enhance the New Zealand Inland Revenue’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 36 exchange of information arrangements in place.

3 The TIEA is based on a model produced by the Organisation for Economic Cooperation and Development (“the OECD”). The TIEA will provide a comprehensive set of rules that support the exchange of information. Information requests can be made only in prescribed circumstances, and information that is received pursuant to a request can be disclosed only to authorised persons, and used by those persons only for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the Contracting Party to which it is given). The text of the TIEA is attached as Annex I.

4 The TIEA will apply on a reciprocal basis. That is, tax officials from New Zealand and Vanuatu will be able to request information from each other. In practice, however, given the more limited nature of Vanuatu’s tax system, New Zealand can be expected to make more requests for information than will Vanuatu.

#### **Nature and timing of proposed binding treaty action**

5 Subsequent to satisfactory completion of the Parliamentary treaty examination process, the TIEA can be incorporated into domestic legislation by Order in Council, pursuant to section BH 1 of the Income Tax Act 2007. The making of the Order in Council is envisaged to be completed by the end of this year.

6 Upon the promulgation of the Order(s) in Council, the TIEA can then be brought into force, through an exchange of diplomatic notes that confirms the completion of the respective constitutional and legal requirements for entry into force by each Contracting Party (Article 12 of the TIEA). Upon entry into force, the TIEA will apply prospectively to all taxable periods beginning on or after 1 January following entry into force (or, where there is no taxable period, to all charges to tax arising on or after 1 January following entry into force).

7 No consultation with the Cook Islands, Niue or Tokelau is required. The TIEA will not apply to these states. (The TIEA applies only for the purposes of New Zealand and Vanuatu taxes. New Zealand tax laws do not apply to the Cook Islands, Niue or Tokelau.)

### **Reasons for New Zealand to become a Party to the treaty**

#### **The TIEA**

8 New Zealand domestic law specifically prohibits Inland Revenue from divulging information it holds to foreign jurisdictions, except when authorised by a tax treaty.<sup>1</sup> 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 TIEAs that allow for the exchange of information on tax matters.

9 Double tax agreements (“DTA”s) are the most common type of tax treaty that feature exchange of information provisions. New Zealand currently has 35 DTAs in force. However, DTAs are typically concluded between trading and investment partners with broadly similar tax systems. To cater for other situations, the OECD produced a model TIEA (with a comprehensive commentary) that provides solely for the exchange of information on tax matters. In 2000, the OECD also published a list of low-tax international finance centres with which member countries are encouraged to establish information sharing arrangements.<sup>2</sup> The 2000 list includes Vanuatu. To date, New Zealand has signed 15 TIEAs with jurisdictions included on the 2000 list.

10 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.

11 The TIEA with Vanuatu will provide 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. However, the TIEA will also ensure that information is not requested or used indiscriminately. Requested information must be “foreseeably relevant” to the tax affairs of a particular person or entity. (The commentary to the OECD model TIEA clarifies that this means that the Contracting Parties are not at liberty to engage in “fishing expeditions”.) In addition, information received pursuant to a request may be disclosed only to authorised persons, and may be used by those persons only for authorised purposes (principally, the administration and enforcement of the domestic tax laws of the respective Contracting Party).

12 Interference from bank secrecy and domestic tax interest rules is specifically prohibited as an obstacle to effective information exchange.<sup>3</sup> Otherwise, rights and safeguards

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<sup>1</sup> Refer to Sections 81 and 88 of the Tax Administration Act 1994. The term “double tax agreement”, as used in section 88, is (by virtue of its legislative definition) also applicable to TIEAs.

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

<sup>3</sup> This is a key aspect of the TIEA. Access to bank information on transactions and savings assists tax administrations to determine whether a person has declared their income correctly. 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 does not itself need that information for tax purposes. TIEAs therefore also

secured to residents of either jurisdiction by domestic law or administrative practice will remain in effect. (Thus, for example, information protected by legal professional privilege will not be required to be provided.) As noted above, the Contracting Parties will be required to maintain strict confidentiality in regarding any information received pursuant to a request.

13 The text of the TIEA is attached as Annex I.

#### **The Understanding on Costs**

14 The TIEA will be supported by a less-than-treaty status instrument. The instrument is an Understanding on Costs between the New Zealand Inland Revenue and the Department of Customs and Inland Revenue of Vanuatu, which sets out the shared understanding of the respective competent authorities on matters of liability, for the costs of obtaining and providing information in response to a request under the TIEA.

15 The less-than-treaty status of the Understanding on Costs will not create legally binding commitments for New Zealand. It is therefore not required to undergo treaty examination. It will be entered into by the New Zealand Inland Revenue and Vanuatu's Ministry of Revenue, prior to entry into force of the TIEA.

#### **Consideration of other options**

16 New Zealand's objective in the negotiations was to secure effective exchange of information arrangements with Vanuatu. The only other possible treaty mechanism for entering into such arrangements with Vanuatu would be as part of a DTA. However, DTAs are designed to be concluded between trading and investment partners with broadly similar tax systems. In addition, New Zealand's DTA negotiation work programme is currently committed to renegotiating existing, older DTAs, and it would not be possible to give the negotiation of a DTA with Vanuatu any priority in the short-to-medium term.

17 Over the past year, there has been increased international pressure on international finance centres, such as Vanuatu, to enter into effective exchange of information arrangements with OECD member countries. New Zealand's approach is consistent with that of other OECD member countries, including that of Australia.

#### **Advantages and disadvantages to New Zealand of the treaty entering into force**

18 Vanuatu is an international finance centre, and many New Zealanders have dealings through legal entities established in Vanuatu to take advantage of low rates of tax. The TIEA will enable New Zealand tax officials to request tax records, business books and accounts, bank information, and ownership information from Vanuatu regarding such dealings. Access to this information will enhance the New Zealand Inland Revenue's ability to detect and prevent tax avoidance and tax evasion. (The TIEA will permit New Zealand to request information regarding "taxes of every kind and description". Its principal application, however, will likely be regarding income taxes.) Any reduction in tax

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override any domestic tax interest rules, with an explicit treaty obligation to provide information regardless of whether or not there is a domestic interest.

avoidance or tax evasion will be beneficial to New Zealand in financial, fiscal and economic terms.

19 Vanuatu is unlikely to raise many requests for information from New Zealand. If requests for information are received from Vanuatu, 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 for New Zealand's existing DTAs and TIEAs. The administrative costs of responding to requests from Vanuatu will therefore 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 may arise.

20 New Zealand may be required to bear some costs regarding requests for information that it makes to Vanuatu. The less-than-treaty status Understanding on Costs, referred to above, sets out the shared understanding of the Contracting Parties with respect to costs, as is required by Article 9 of the TIEA. "Ordinary" costs of complying with a request will be borne by the requested Contracting Party, but "extraordinary costs" (such as the cost of hiring translators or interpreters) will be reimbursed by the requesting Contracting Party. However, prior consultation will be required if extraordinary costs appear likely to exceed US\$1,000. This will ensure that New Zealand will progress information requests giving rise to significant reimbursement costs only if the need to obtain the information justifies the expenditure.<sup>4</sup>

21 The conclusion of the TIEA with Vanuatu will also enable New Zealand to list Vanuatu as an approved territory for the purposes of the venture capital exemption at section CW 12 of the Income Tax Act 2007. The purpose of the section CW 12 exemption is to facilitate increased venture capital into New Zealand. It does this by exempting qualifying foreign investors from approved territories from paying income tax on any gains derived from the sale of shares in qualifying venture capital investments. Under existing policy, it is possible to approve territories for the purposes of the section CW 12 exemption only when effective exchange of information arrangements are in place.

22 On balance, it is in New Zealand's interests to conclude the TIEA with Vanuatu.

### **Obligations**

23 The TIEA will impose a reciprocal obligation on each Contracting Party to provide, upon request, information that is foreseeably relevant to the administration and enforcement of specified taxes. In the case of Vanuatu, the specified taxes are "taxes of every kind and description", (see article 2(1)(a)). As noted above, Vanuatu is unlikely to make many requests for information from New Zealand.

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<sup>4</sup> In recognition of the possibility that capacity issues in Vanuatu may mean that, on occasions, Vanuatu may struggle to find the staff or other resources to comply with a single or multiple requests for information from New Zealand, the Understanding on Costs also provides that the two sides may consult in such circumstances with a view to finding solutions. For example, where it is important for Inland Revenue to obtain the information, New Zealand may agree to pay a larger share of the costs.

24 The Contracting Parties will be required to maintain strict confidentiality regarding any information received pursuant to a request. Such information may be disclosed only to authorised persons, and may be used only for specified purposes (principally, the administration and enforcement of the domestic tax laws of the respective Contracting Party, see Article 8).

25 In the Understanding on Costs, the respective tax authorities set out their shared understanding of how costs incurred in providing assistance will be addressed. The requesting Contracting Party is to reimburse the requested Contracting 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 Contracting Party. Prior consultation will be required if extraordinary costs appear likely to exceed US\$1,000.

26 Reservations are not provided for under the TIEA.

27 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 Vanuatu, the Minister of Finance or the Minister’s authorised representative). The Parties may also decide upon other forms of dispute resolution.

### **Implementation**

28 Subject to the successful completion of the Parliamentary treaty examination process, the TIEA will be implemented into New Zealand domestic law by Order 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.<sup>5</sup> 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. Therefore, the TIEA falls within the ambit of section BH 1.

29 Upon completion of the Parliamentary treaty examination process, officials will arrange for an Order in Council to be made, and for the other steps for entry into force to be undertaken. This includes New Zealand notifying Vanuatu by diplomatic note that all of its domestic constitutional and legal procedures for entry into force of the TIEA are complete. Vanuatu will likewise notify New Zealand when its own procedures are complete. It is expected that this process will be completed before the end of the year.

30 There are no other viable regulatory options for implementing the obligations in the agreement.

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<sup>5</sup> 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 for these Acts.



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

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

**Costs to New Zealand of compliance with the agreement**

32 New Zealand will be required to reimburse Vanuatu 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 on Costs provides for consultation if extraordinary costs appear likely to exceed US\$1,000. This will ensure that New Zealand will progress information requests giving rise to significant reimbursement costs only if the need to obtain the information justifies the expenditure.

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

34 All costs arising to Inland Revenue as a result of the operation of the agreement will be met within existing baselines.

**Consultation**

35 The Ministry of Foreign Affairs and Trade, and the Treasury, have been consulted and agree with the proposed treaty action. (They did not raise any concerns with this NIA.) Further, the concept of TIEAs in general has been canvassed in the government's published policy work programmes.

**Future protocols**

36 No future amendments are anticipated. New Zealand will consider any proposed amendments to the TIEA 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**

37 Article 13 of the TIEA provides that either Contracting Party may terminate the TIEA by giving six months' written notice through the diplomatic channel. The Contracting Parties will remain bound by the confidentiality provisions contained in Article 8 of the TIEA even after it has been terminated.

38 Any decision by New Zealand to terminate the TIEA would be subject to the usual domestic approvals and procedures.

**Agency disclosure statement**

39 Inland Revenue has prepared this extended national interest analysis. It has undertaken an analysis of the issue of implementing a TIEA between New Zealand and Vanuatu, and the legislative and regulatory proposals arising from that implementation. It has considered

all other relevant options in that process. Inland Revenue is of the view that there are no significant constraints, caveats or uncertainties concerning the regulatory analysis.

40 An Order in Council is required to implement the TIEA into New Zealand domestic law.

41 Inland Revenue is of the view that the policy options considered will not impose additional costs on businesses; impair private property rights or market competition; adversely impact the incentives on businesses to innovate and invest; or override fundamental common principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).

42 Inland Revenue notes that the form of this TIEA and National Interest Analysis is consistent with that of a number of previous TIEAs and National Interest Analyses prepared regarding other TIEAs concluded by New Zealand. The conclusion of a Supplementary Agreement in support of the TIEA is consistent with the approach adopted with previous TIEAs that New Zealand has signed, and the terms of the Supplementary Agreement largely duplicate those in existing treaties.