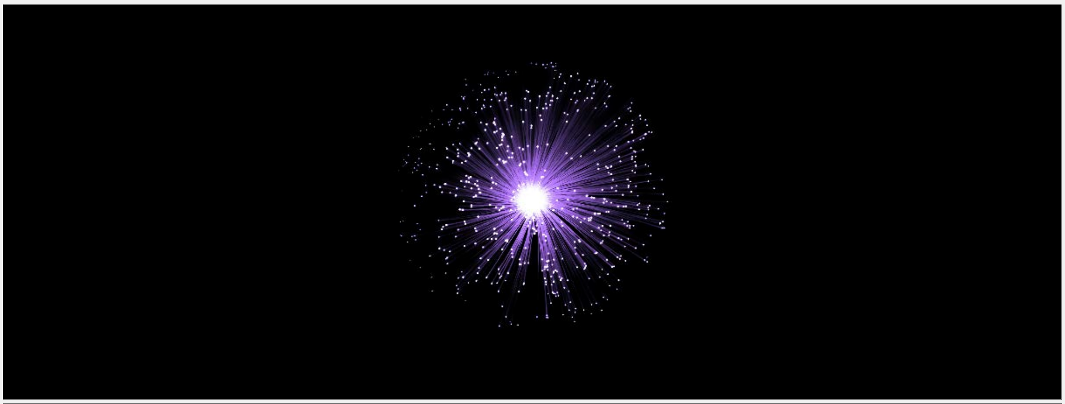

New Zealand issues BEPS consultation papers

Global Transfer Pricing Alert 2017-004

New Zealand's Minister of Revenue and the Finance Minister on 3 March released three BEPS consultation papers that address the following:

- Tackling concerns about multinationals booking profits from their New Zealand sales offshore, even though the sales are driven by New Zealand-based staff;
- Preventing multinationals from using interest payments to shift profits offshore by strengthening the interest limitation rules; and
- Implementing the multilateral instrument (MLI) to align New Zealand's tax treaties with the OECD recommendations.

In a media statement that accompanied the release of the consultation papers, the ministers acknowledged that although New Zealand's broad-base low-rate tax system operates well by global standards, it is important to ensure that the system continues to evolve to ensure that all companies operating in the country are paying their fair share of tax.

Transfer pricing and avoidance of permanent establishment (PE) status

This discussion document proposes to strengthen New Zealand's transfer pricing and source rules, prevent the abuse of tax treaties, and limit the ability to avoid PE status.

Transfer pricing: The consultation paper contains the following proposed changes to the transfer pricing rules:

- The rules would be aligned with the OECD's transfer pricing guidelines and, to some extent, with Australia's newly implemented transfer pricing rules;
- The burden of proof regarding whether the actual conditions of an arrangement are aligned with arm's length conditions would be shifted from the tax authorities to the taxpayer;
- The statute of limitations for transfer pricing issues would be increased from four years to seven years; and
- The scope of the transfer pricing rules would be extended to investors that "act together."

Avoidance of PE status: The government proposes to introduce a new anti-avoidance rule for large multinationals (those with consolidated global turnover exceeding EUR 750 million, approximately NZ$1.13 billion) that are deliberately structured to avoid having a PE (and therefore, a taxable presence) in New Zealand. This rule would deem a nonresident entity to have a PE in New Zealand if a related entity carries out sales-related activities for it in New Zealand, if some or all of the sales income is not attributed to a New Zealand PE of the nonresident, and the arrangement aims to defeat the purpose of the PE provision in the relevant tax treaty.

Administrative rules and effective dates: The administrative rules would be significantly strengthened to deal with uncooperative large multinationals. Taxes in dispute would have to be paid earlier in the dispute process when the dispute relates to transfer pricing. The commissioner would be allowed to collect tax payable by a large multinational from any wholly owned group member in New Zealand, or in the case of the new PE rule, the related New Zealand entity.

The discussion document suggests that the above proposals would apply to income years beginning on or after the enactment of the relevant legislation.

Interest deductibility limitation rules

In the discussion document on interest deductibility limitation rules, the government includes proposals to further strengthen New Zealand's thin capitalization regime rather than take the OECD approach of limiting interest deductions to a percentage of EBITDA. However, the EBITDA approach has not been definitively rejected and will be reconsidered if the proposed measures are not effective.

Broadly, it is proposed that there would be a limit on the deductible interest rate on related-party loans from a non-resident lender to a New Zealand borrower. The government is of the view that such a rule would ensure that the interest rate on such loans is roughly in line with the rate the borrower would agree to with a third-party lender. This is designed to reduce or eliminate costly disputes over an appropriate interest rate under the standard transfer pricing rules.

The discussion document includes other proposals relating to interest, including the introduction of a *de minimis* level for the inbound thin capitalization rules (provided the debt is not owner-linked) and proposals to reduce the ability of companies owned by a group of nonresidents to use related-party debt.

The discussion document suggests a delayed application date to allow businesses to arrange their affairs as required, with proposals applying to the income year beginning after the enactment of the relevant legislation.

Multilateral instrument

The third consultation document aims to explain what the MLI is and how it would operate to amend New Zealand's tax treaty network.

The MLI can be viewed as a way to facilitate a large-scale simultaneous negotiation to modify bilateral tax treaties to include treaty-related BEPS measures (otherwise known as the substantive provisions, as outlined in the BEPS final reports on actions 2, 6, 7, and 14), and to enable jurisdictions to meet the OECD's minimum standards on treaty abuse and dispute resolution. Jurisdictions may not choose to apply different articles of the MLI to different treaties, and must decide which treaties they would like to include as part of a "covered tax agreement" and their choices of articles. Following this step, jurisdictions must ascertain how the treaty would be modified by the MLI (as governed by the substantive provisions).

The substantive provisions fall into two categories: minimum standards and optional provisions. These provisions address BEPS concerns in four key areas:

1) *Preventing the granting of treaty benefits in inappropriate circumstances* through the insertion of a "principal purpose test" or equivalent provision into CTAs.
2) *Preventing the artificial avoidance of PE status* by adding a requirement to clarify the PE definition carve-outs to prevent entities structuring to avoid paying tax on its profits.
3) *Neutralizing the effects of hybrid mismatch entities* by adopting articles 3 and 4 of the MLI in relation to fiscally transparent entities and dual resident entities respectively.
4) *Providing improved mechanisms for effective dispute resolution* so that taxpayers may request the application of a mutual agreement procedure (MAP) where they believe that taxation is not in accordance with the treaty (or where the treaty does not contain a MAP). If a MAP is included in the relevant treaty, the MLI will amend the treaty to allow taxpayers to approach the competent authorities in either jurisdiction to clarify any uncertainty as to how the treaty should apply.

The MLI will be signed by a number of participating jurisdictions in June 2017, after which the MLI will go through New Zealand's domestic treaty-making process. The MLI will enter into force generally (in its own right) and for the states that have ratified it, three to four months after the fifth jurisdiction has ratified the MLI. The MLI will enter into effect to modify each bilateral tax treaty, on a phased-in basis, once both treaty partners have signed and ratified the MLI. The precise dates on which New Zealand's treaties will begin to be modified are unknown, but it is likely that the earliest modifications will occur in 2019.

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