Chapter 25: New Zealand

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25.1. Anti-BEPS measures before the BEPS Project and policy impact of the BEPS Project

New Zealand is a small country with an open economy that is well known for having an efficient and robust tax system. When it comes to international tax, New Zealand tends to prefer being a follower rather than a leader or early adopter. Under successive governments during the last 15 to 20 years, New Zealand has supported the work of the OECD, ensuring that it is – in all material respects – compliant with OECD recommendations and guidance. The release of the 15 Actions under the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project has seen the level of activity (by both officials and politicians) in New Zealand increase significantly.

New Zealand considers its tax system to be largely robust and generally free from significant aggressive tax planning or base erosion and profit shifting prior to the announcement of the BEPS Project. New Zealand has made us of a general anti-avoidance rule (GAAR) for over 100 years for income tax, with the current rule found in section BG 1 of the Income Tax Act (2007) (ITA).[1] There is also a similar GAAR in section 76 of the Goods and Services Tax Act (1985),[2] along with a number of specific anti-avoidance rules (SAARs). Due to these sections in the legislation being framed in very broad terms, it has been left to the courts to interpret and apply the provisions, with the Supreme Court establishing the parliamentary contemplation test in 2008. Since that time, New Zealand's Inland Revenue has won almost every case heard by the courts. Most omnibus tax bills each year would have a number of remedial and base protection amendments that deal with, generally, what are perceived (or, in some cases, actual) risks to the New Zealand tax base. As New Zealand is not a part of the European Union, any EU initiatives are not directly relevant unless they have been endorsed by the OECD.

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* This paper sets out developments as at 31 Mar. 2019.

1 NZ: Income Tax Act, 2007 [hereinafter ITA].

2 NZ: Goods and Services Tax Act, 2007.

New Zealand's Peer Review Report under the OECD Global Forum[3] initiative determined that New Zealand was overall compliant. New Zealand was categorized as compliant on all but one aspect (on which aspect it was categorized as "largely compliant").[4] New Zealand welcomed this Report, indicating that it accepted the recommendations and would make the necessary changes. New Zealand also indicated that it fully endorses the international standards of transparency and exchange of information.[5]

The earlier OECD reports, including those addressing issues of harmful tax practices,[6] have been referred to infrequently in New Zealand tax reform proposals. This can be attributed to the absence of harmful tax practices identified in New Zealand's tax system, along with New Zealand's view that it did not support harmful tax competition. One instance where there was a perceived risk of a harmful tax practice concerned the benefits and risks associated with applying source-based taxation to non-resident portfolio investment entity investors through allowing a 0% tax rate to apply for non-resident investors.[7] Prior to the BEPS work by the OECD on hybrid mismatches, the associated issues did not feature in any policy proposals within New Zealand, although the consequences of hybrid mismatches were emerging during the early 2010s. One example of a hybrid mismatch that reached the New Zealand courts was seen in the *Alesco NZ v. Commissioner of Inland Revenue* (*Alesco*) case.[8]

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[3] The Global Forum on Transparency and Exchange of Information (Global Forum) works to further the OECD's work to address the risks to tax compliance posed by non-cooperative jurisdictions. The original members of the Global Forum consisted of OECD countries and jurisdictions that had agreed to implement transparency and exchange of information for tax purposes.

[4] OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes, *New Zealand: Peer Review Report Combined: Phase 1 + Phase 2, Incorporating Phase 2 Ratings* (OECD 2013) [hereinafter *New Zealand: Peer Review Report* (2013)]. The area of "largely compliant" covered ownership and identity information. This followed the first report issued in 2011.

[5] OECD, *New Zealand: Peer Review Report* (2013), *supra*, at p. 99.

[6] OECD, Committee on Fiscal Affairs, *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998) [hereinafter *Harmful Tax Competition* (1998)]; OECD Ctr. for Tax Policy & Admin., *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* (OECD 2001) [hereinafter *2001 Progress Report* (2001)].

[7] Inland Revenue, *Allowing a Zero Percent Tax Rate for Non-Residents Investing in a PIE: An Officials' Issues Paper* (Apr. 2010).

[8] NZ: SC, 9 July 2013, *Alesco NZ v. Commissioner of Inland Revenue*, [2013] NZCA

A number of BEPS-related measures had already been proposed prior to finalization of the BEPS Project or were in the pipeline in New Zealand. No action was taken by New Zealand to counteract base erosion and profit shifting prior to the launch of the BEPS Project, which is not surprising given many of the BEPS issues were not present (for example, there were no identified harmful tax practices).

In June 2016, Inland Revenue commented on New Zealand's position with respect to where the country was placed concerning BEPS. Specifically, Inland Revenue commented on what it had completed (and proposals in the pipeline, most of which are now implemented or under consultation) with respect to how it has made New Zealand's tax law more robust; increased international cooperation; and improved transparency and exchange of information.[9]

Several confidential advice papers prepared for the Minister of Revenue were released publicly in 2014, setting out a timeline for New Zealand's response to the BEPS Project and the degree of progress in that regard.[10] This included specific progress on each of the 15 BEPS Actions. Progress updates on the taxation of multinational enterprises (MNEs) were released from late 2012 through 2013.[11] Clearly, the approach taken by the New Zealand government was to ensure that taxpayers and tax advisers were aware of New Zealand's approach and progress on BEPS-related issues.

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[9] Inland Revenue, *New Zealand's Plan to Ensure Multinationals Pay Their Fair Share of Tax* (June 2016), available at http://taxpolicy.ird.govt.nz/publications/2016-other-beps-fact-sheet/overview (accessed 10 Apr. 2019).

[10] Inland Revenue (Policy and Strategy Group), *Timeline for BEPS-Related Tax Policy Work* (Nov. 2014), available at https://taxpolicy.ird.govt.nz/publications/2014-other-beps-report/overview (accessed 10 Apr. 2019) and Inland Revenue (Policy and Strategy Group), *BEPS Progress update* (Aug. 2014).

[11] Inland Revenue (Policy and Strategy Group), *Taxation of Multinational Companies* (Dec. 2012). *See also* Inland Revenue (Policy and Strategy Group), *Taxation of Multinationals: Update* (Apr. 2013), available at https://taxpolicy.ird.govt.nz/news/2013-04-18-update-beps-work (accessed 10 Apr. 2019); Inland Revenue (Policy and Strategy Group), *Taxation of Multinationals* (Aug. 2013); Inland Revenue (Policy and Strategy Group), *Further work on taxation of multinationals* (Oct. 2013), available at http://taxpolicy.ird.govt.nz/news/2013-10-25-further-work-taxation-multinationals (accessed 10 Apr. 2019).

The BEPS Project has been central to the development of international tax policy in New Zealand over the last 2 to 3 years. The media have highlighted the content of consultation papers, drawing parallels between New Zealand's approach and that of other jurisdictions, such as Australia and the United Kingdom.

25.2. Measures against hybrid mismatch arrangements: BEPS Action 2

Prior to the commencement of the BEPS Project, there were no specific plans to address hybrid mismatches, other than specific instances of mismatches detected through audits and reviews of taxpayer returns. However, as mentioned, a significant case involving a hybrid mismatch was the *Alesco* case,[12] which concerned the issuing of optional convertible notes between an Australian company and its wholly-owned New Zealand subsidiary.

The High Court and Court of Appeal concurred with the Commissioner of Inland Revenue (Commissioner) that the issue of these optional convertible notes constituted a tax avoidance arrangement, with a confidential settlement being reached between the Commissioner and Alesco NZ just prior to the Supreme Court appeal hearing in 2014. This case served as a test case for a number of other MNEs using optional convertible notes. A number of these MNEs have subsequently settled with the Commissioner. Thus, it is possible that the Commissioner can continue to succeed under the GAAR without having need for specific anti-hybrid rules. No specific measures against hybrid mismatches were enacted after *Alesco* but changes were signalled in a discussion document issued in September 2016[13] that New Zealand would

12 *Alesco* (2013), *supra* n. 8. This case involved the issuance by Alesco NZ Ltd of optional convertible notes to Alesco Corporation Limited (its parent company in Australia) in return for advances totalling NZD 78 million for a term of 10 years. Alesco Corporation Limited had the option of being repaid NZD 78 million or converting the notes into new Alesco New Zealand Limited shares worth NZD 78 million. Alesco NZ claimed amortized interest deductions in accordance with the financial arrangements rules, which stipulated that such "hybrid" instruments be treated as containing both debt and equity elements. This interest notionally received by Alesco Corporation Limited was not taxable, as the notes were treated as equity instruments under Australian tax law. The New Zealand Commissioner of Inland Revenue contended that the optional convertible notes were a structured financial product that Alesco Corporation Limited bought from KPMG (its tax advisor) for the purpose of allowing the taxpayer to obtain impermissible tax benefits in New Zealand. The Commissioner's view, applying economic reality, was that this constituted tax avoidance.

13 Hon. Bill English & Hon. Michael Woodhouse, *Addressing Hybrid Mismatch Arrangements: A Government Discussion Document* (Sept. 2016).

follow the OECD's recommendations contained in the Action 2 Final Report (Action 2)[14] in their entirety and introduce specific anti-avoidance provisions for hybrids. Action 2 sets out numerous possible instances of hybrid mismatch arrangements and provides detailed recommendations (such as the scope of the rules, definitions and a number of sample provisions). The discussion document traversed these proposals, setting out specific questions for submitters to comment on.

Submissions in respect of the discussion document closed on 17 October 2016. Despite lengthy consideration of these, the government confirmed in August 2017 that it would continue with its decision to adopt the "full suite of OECD recommendations on hybrid and branch mismatches".[15] Even after a change of government following the September 2017 general election, the incoming government has continued with the outgoing government's work on incorporating BEPS-related provisions into domestic law with the introduction of the Taxation (Neutralising Base Erosion and Profit Shifting) Bill 2017 to Parliament on 6 December 2017 (Tax Bill 2017).[16] This Bill contained a range of measures to deal with PE avoidance and to strengthen New Zealand's thin capitalization rules and comprehensive rules to address hybrid mismatch arrangements that exploit differences between countries' tax rules in order to achieve an advantageous tax position.

While it is beyond the scope of this chapter to review all the submissions on the discussion document on hybrid mismatches, the submissions of the New Zealand Law Society (NZLS) and Chartered Accountants Australia and New Zealand (CA-ANZ) are indicative of the wider opinion in New Zealand in respect of the hybrid mismatch proposals.[17]

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14 OECD/G20, *Neutralising the Effects of Hybrid Mismatch Arrangements – Action 2: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD.

15 Inland Revenue (Policy and Strategy Group), *Base erosion and profit shifting: A summary of the key policy decisions* p. 7 (Aug. 2017).

16 NZ: Taxation (Neutralising Base Erosion and Profit Shifting) Bill 2017, 6 Dec. 2017 [hereinafter Tax Bill 2017]. This Bill has subsequently been enacted. The progress of the Bill can be found at https://www.parliament.nz/en/pb/bills-and-laws/bills-proposed-laws/document/BILL_75623/tab/submissionsandadvice (accessed 10 Apr. 2019).

17 NZLS, *Submission on: Addressing Hybrid Mismatch Arrangements: A Government Discussion Document* (15 Nov. 2016); CA-ANZ, *Submission on: Addressing Hybrid Mismatch Arrangements* (Oct. 2016).

The NZLS, in its submission, largely supported the proposals, but expressed the concern that a number of the proposals contained in the discussion document could impose an undue burden on New Zealand taxpayers while seeking to further the global benefits of Action 2. The NZLS sought information quantifying the risk to the New Zealand tax base and the implications for New Zealand tax sovereignty should the New Zealand government enact rules to compensate for shortcomings in the global tax net. The NZLS then worked through each of the detailed proposals, expressing concern over a number of them. It also recommended a different order of preference in the choice of options set out in the discussion document.

The CA-ANZ submission accepted the need for New Zealand to be a good global tax citizen, but stated as follows:[18]

> However, we are not convinced that adopting the OECD's recommendations for addressing hybrid mismatches in the manner and timeframe envisaged is the correct approach. Rather we are *concerned that adoption of the OECD's very broad recommendations as set out in the Discussion Document in the implied timeframe of the next two years or less would be to the detriment of New Zealand businesses and the New Zealand economy generally*. (Emphasis added.)

Submitters argued that New Zealand should be focusing more on protecting its own national interests than taking into account other countries' responses. It recommended that New Zealand not be an early adopter, but rather a follower. In moving forward, the authors endorse the recommendation of CA-ANZ, such that:[19]

> In our view the Government would be better advised to take a *targeted approach to addressing hybrid mismatch arrangements*. By this we mean an approach whereby any amendments to New Zealand's domestic tax laws are focused specifically on the use of hybrid entities or instruments in New Zealand that the *Government does not believe can be addressed by the existing law including the general anti-avoidance rule*.
> A more targeted approach would result in law reform that is *more relevant to the New Zealand 'context'*. It would also be able to take into account that New Zealand already has robust primary rules including the denial of foreign dividend exemptions for deductible dividends and a powerful and judicially supported general anti-avoidance rule. (Emphasis added.)

The CA-ANZ, like the NZLS, then worked through the specific issues, recommending a number of significant changes. Both these organizations lodged similar submissions in

[18] CA-ANZ, *supra*, at p. 1.

[19] Id., at p. 5.

respect of the Tax Bill 2017 but as many of their submissions on the earlier discussion document were not adopted, it was improbable that the government would make further changes to the Bill as a result of the second lot of submissions received. Consequently, only minor changes were made to the Tax Bill 2017 prior to its enactment.

The authors largely concur with the views of NZLS and CA-ANZ that a better targeted approach would be preferable in respect of hybrid mismatches. By a targeted approach, the authors believe that New Zealand should adopt those OECD recommendations that are necessary to protect its tax base where the GAAR is not expected to be sufficient. New Zealand also needs to ensure that its legislation does not facilitate the use of hybrids that support non-compliance in other jurisdictions. This would see the changes to New Zealand's law being relevant to the New Zealand context. This approach would suggest that, should further changes be necessary, i.e. if the GAAR in section BG 1 of the ITA or in section 76 of the Goods and Services Tax Act (1985)[20] does not prove to be sufficient, these changes could be implemented by amending legislation.

25.3. Controlled foreign company rules: BEPS Action 3

New Zealand enacted controlled foreign company (CFC) rules with effect from April 1988 as part of a comprehensive package to stem tax avoidance by its residents using offshore entities.[21] Initially, the CFC rules applied to all offshore entities with (a) controlling New Zealand shareholder(s), with an exemption for companies resident in what was termed a "grey list country".[22] As no exemption for "active" income was offered, the result was a very broad and comprehensive CFC regime. A foreign tax credit is allowed against New Zealand tax payable on any income attributed to a New Zealand shareholder. CFC losses are quarantined on a jurisdiction basis.

In 2009, the CFC rules were revised to make them comparable to the Australian CFC rules,

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20 NZ: Goods and Services Tax Act, 1985.

21 The CFC rules are found in Subpart EX ITA.

22 This grey list initially included Australia, Canada, France, Germany, Japan, the United Kingdom and the United States. France was later removed from the list, while Norway and Spain were added.

improving the competitiveness of New Zealand companies offshore. From 2009, the exemption for grey list countries was reduced to only one country, namely Australia. Secondly, an "active" income exemption was introduced that applies to all companies resident in the rest of the world. To be exempt from income attribution, no more than 5% of a CFC's total income may come from passive sources.

New Zealand CFC rules did not require any changes to bring them into line with OECD BEPS best practice, as they already met all the recommendations in the six building blocks found in the BEPS Action 3 Final Report (Action 3).[23,24] New Zealand's CFC rules apply to all interests of New Zealand tax residents in non-resident companies if five or fewer residents have more than a 50% interest in those companies, or a single resident holds a 40% or more interest in those companies. As there are no exemptions from the scope of the rules if a non-resident company is located in a specific country, they apply to all non-resident corporate entities. Thus, the New Zealand CFC rules are more rigorous than the recommendations contained in the first two building blocks in Action 3. Income from a CFC must be attributed to the resident shareholders if their "income interest" (effective economic interest) in the CFC's capital is 10% or more.

There are two exclusions from the income attribution requirement. The first is if the company is resident in Australia and the second if its passive income (interest, dividends, royalties and rents) is less than 5% of the CFC's total income. These provisions are consistent with the recommendations in the third, fourth and fifth building blocks of Action 3. Foreign tax credits are allowed against the New Zealand tax payable on any attributed CFC income, while dividends paid by a CFC to New Zealand corporate shareholders are exempt from tax – which is consistent with the sixth building block of Action 3.

Because New Zealand CFC rules are very comprehensive, there is no need for other rules (such as passive foreign investment company rules) to protect the New Zealand tax base from tax avoidance by its tax residents using offshore entities. New Zealand's CFC rules are buttressed with comprehensive foreign investment fund (FIF) rules that apply to interests in

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[23] New Zealand's CFC rules are found in Subpart EX ITA.

[24] OECD/G20, *Designing Effective Controlled Foreign Company Rules – Action 3: Final Report* (OECD 2015), International Organizations' Documentation IBFD.

non-resident companies and funds when they do not fall within the scope of the CFC rules.[25]

25.4. Interest deductions and other financial payments: BEPS Action 4

New Zealand has a generous provision for interest deductibility by companies. Under section DB 7 of the ITA, all interest expense incurred by a company is deductible unless it is incurred in producing certain types of exempt income.[26] Non-resident companies are also eligible to claim an interest deduction under section DB 7, but only to the extent that the interest expense is incurred in the course of carrying on a business through a “fixed establishment” (i.e. permanent establishment (PE)) in New Zealand. If a company is not eligible to claim a deduction under section DB 7, the company is still eligible to claim an interest deduction under section DB 6 of the ITA, which requires the taxpayer to establish a nexus between the interest expense and the derivation of assessable income.

Any interest deduction falling within sections DB 6 and DB 7 may still be subject to apportionment under thin capitalization rules, which apply to both inbound and outbound investment. These thin capitalization rules are found in Subpart FE of the ITA and were first introduced in 1996. They were subsequently tightened in 2011 by reductions in the safe harbour debt-to-assets ratio.

In the case of inbound investment, the thin capitalization rules apply where the taxpayer is a non-resident company or a resident company controlled by non-residents.[27] In the case of outbound investment, the thin capitalization rules apply where a resident company has offshore CFC and/or foreign investment fund interests which result in no income attribution to the New Zealand company due to the active income exemption offered under the CFC rules.

Under the thin capitalization rules, interest apportionment occurs when the New Zealand

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25 The foreign investment fund rules are set out in Subpart EX ITA.

26 *See* sec. DB 7(3) ITA.

27 There is a separate set of thin capitalization rules that apply to New Zealand registered banks which are linked to bank regulatory capital requirements and regulations. These are significant, as most New Zealand registered banks are foreign-owned.

company’s debt percentage (the ratio of interest-bearing debt to total assets) exceeds 60% in the case of inbound investment and 75% for outbound investment. In the case of a worldwide group of which the resident entities are part, a higher debt percentage may apply, provided that the resident entities’ debt percentages do not exceed 110% of the worldwide group debt percentage.

Where the thin capitalization rules apply to outbound investment, there are further concessions that limit the situations in which apportionment of interest expense could arise under the rules. If the New Zealand group assets are 90% or more of the worldwide group assets, there is no apportionment under the rules. There is also a de minimis rule under which no apportionment arises if the interest costs are less than NZD 1 million, with a tapering where the costs are above NZD 1 million and below NZD 2 million.

There is also the option for the application of the thin capitalization rules to outbound investment where, instead of apportionment being determined according to debt percentages, the taxpayers elect to use a ratio based on interest expense to pre-tax cash flows. If this option is adopted, no interest apportionment will arise if the ratio of net interest expense to net income of the New Zealand group does not exceed 50% or 110% of the worldwide group’s interest expense ratio.

New Zealand’s thin capitalization rules were not compliant with the BEPS recommendations in several ways. First, the New Zealand rules were largely balance sheet-based, with apportionment based on a ratio of interest-bearing debt to total assets rather than the income ratio-based approach. Only in the case of outbound investment could an income ratio-based apportionment be adopted as an option; it was not available in the case of inbound investment. Second, the BEPS proposals suggested that a threshold ratio of between 10% to 30% of interest expense to EBITDA be adopted, while the New Zealand rules had a threshold ratio of 50% interest expense to EBITDA for outbound investment only. Third, there was no scope to carry forward any disallowed interest expense under the thin capitalization rules to future income years, nor any carve-out from the thin capitalization rules for third-party borrowing for infrastructure projects.

On the other hand, the New Zealand rules complied with the BEPS recommendations in that there is a provision to relax the threshold ratio based on the worldwide income ratio.

Furthermore, there was a de minimis exemption from the apportionment rules for outbound investment.

In March 2017, the New Zealand government released a discussion document titled *BEPS – Strengthening Our Interest Limitation Rules*,[28] outlining proposed changes to New Zealand's thin capitalization rules in response to the BEPS Action 4 Final Report (Action 4),[29] and seeking public feedback. Notably, the government did not commit to shifting from a debts-to-assets-based rule to an EBITDA rule, although the discussion in the rest of the discussion document suggested that the debts-to-assets-based rule would be retained (which was subsequently confirmed in August 2017).

After considering submissions received in response to the above discussion document, in August 2017, the New Zealand government[30] enacted the following changes to interest deductibility rules in response to the Action 4 recommendations.

Firstly, although a cap on the interest rates charged on related-party debt was initially proposed in the discussion document, this has been replaced by a "restricted transfer pricing rule" in the Tax Bill 2017. This rule operates by establishing the group credit rating of the New Zealand borrower where there is a "high BEPS risk". A "high BEPS risk" is where the New Zealand borrower has (i) a high level of debt in New Zealand (more than 40% of its assets); or (ii) high interest costs; or (iii) debt through a nil or low-tax jurisdiction. In these instances, the applicable interest rate will be set using the foreign parent's credit rating minus 1 unless the borrower's own credit rating is equal to or higher than its parent's credit rating.

In cases where the presumed credit rating approach does not apply, the borrower's standalone

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28 Hon. Steven Joyce & Hon. Judith Collins, *BEPS – Strengthening Our Interest Limitation Rules: A Government Discussion Document*, Policy and Strategy, Inland Revenue Department, Wellington (Mar. 2017).

29 OECD/G20, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments – Action 4: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD.

30 *See* media statement of Hon. Steven Joyce & Hon. Judith Collins, *Government Announces BEPS Decisions* (3 Aug. 2017), available at http://taxpolicy.ird.govt.nz/news/2017-08-03-govt-announces-beps-decisions#statement (accessed 10 Apr. 2019).

credit rating can be used. When determining an appropriate interest rate for related-party debt, the following terms and conditions are to be disregarded:

- loan terms of more than 5 years;
- subordination; and
- unusual features (such as interest payment deferral, convertibility at the option of the borrower) generally not found with arm's length financing.

Secondly, "non-debt liabilities" (being those liabilities that are not interest-bearing) are to be deducted from the entity's assets in calculating the debt-to-assets ratio.

Thirdly, the current de minimis rule for interest expense less than NZD 1 million applying to the outbound thin capitalization rules would be extended to inbound investment, unless the debt is "owner-linked".

Fourthly, in future, assets' current market values will have to be made or verified by independent expert valuers with the current option to adopt values calculated using financial reporting standards.

Fifthly, there will be a carve-out for certain infrastructure projects for third-party borrowing where the project is controlled by a single non-resident party.

Some of the proposed changes raised concerns in the business and professional communities, as evidenced by the number of submissions to discussion document proposals[31] and to revised provisions appearing in the current bill. While concerns about the proposed interest cap found in the discussion document were acted on, the credit rating approach contained in the bill also attracted adverse comment especially as this basis appears out of step with international practice.[32] A substantial number of these submissions on the credit-rating approach were also adopted when the bill was finally passed in 2018.

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[31] *See* e.g. NZLS, *Submission on: Base Erosion and Profit Shifting (BEPS): Strengthening our interest limitation rules* (1 May 2017); CA-ANZ, *Submission on: BEPS: Strengthening our interest limitation rules* (20 Apr. 2017).

[32] *See* Chartered Accountants Australia and New Zealand, *Submissions on the Taxation (Neutralising Base Erosion and Profit Shifting) Bill* pp. 5-17 (8 Feb. 2018), as indicative of many of the submissions on these proposals in the current bill.

25.5. Countering harmful tax practices: BEPS Action 5

As noted in section 25.1., New Zealand was not found to have any harmful practices following its Global Forum Peer Review in 2013.[33] Consequently, the New Zealand government has not felt it necessary to develop policy and legislation to remove any harmful practices. Furthermore, as noted, earlier OECD reports (including the report on harmful tax practices),[34] have been referred to occasionally in tax reform proposals. New Zealand also does not support harmful tax competition.

The 1998 OECD harmful tax competition report[35] had little direct relevance to New Zealand, as the country does not have the characteristics of a tax haven, namely: no or low taxes; lack of effective exchange of information; lack of transparency; and no requirement of substantial activity. When looking at New Zealand's tax system overall, with its broad base and relatively high rates of tax, it is clear that it is not a tax haven in the general sense of the concept.

As New Zealand is not a member of the European Union, EU developments are not relevant. Furthermore, there has not been any discussion of the issue of state aid in New Zealand, as this is an issue that features prominently in the European Union. This may in part be attributable to the underlying policy approach of adopting a broad base/low rate (BBLR) system. The BBLR is a coherent tax policy framework that seeks to appropriately balance (with trade-offs) a number of factors, namely efficiency, fairness, compliance costs and administration costs. It aims to have a broad base of taxation while keeping tax rates as low as possible.[36]

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[33] OECD, *New Zealand: Peer Review Report* (2013), *supra* n. 4.

[34] OECD, *Harmful Tax Competition* (1998), *supra* n. 6; OECD, *2001 Progress Report* (2001), *supra* n. 6.

[35] OECD, *Harmful Tax Competition* (1998), *supra* n. 6.

[36] For further discussion of the BBLR in a New Zealand context, *see* A. Sawyer, *Do Lawyers Make a Distinctive Contribution to Tax Policy-Making?: Reflections on the Contributions of Lawyers to Tax Policy-Making in New Zealand*, 27 NZ Universities L. Rev. 4, pp. 995-1022 (2017).

Nevertheless, the BBLR has some perceived deficiencies. For example, economic theory would argue that the most efficient mechanism to raise tax revenue would be to apply different tax rates to each taxpayer depending on its individual elasticities. The BBLR does not do this and, as such, is an example of where pragmatism outweighs economic theory. The BBLR also does not correct for positive and negative externalities to the extent that traditional economic theory would advocate (such as for failures to recognize the impact on the environment from economic activities). From a practical implementation perspective, a major deficiency of the BBLR base in New Zealand is the absence of a comprehensive capital gains tax, or at least taxation of wealth, land holdings and the like. Whether New Zealand should move down the path of developing and implementing a comprehensive capital gains tax is a contentious issue politically.[37]

Subsequent to the 2014 OECD report, with respect to the Action 5 Deliverable,[38] one area where New Zealand potentially had a harmful tax practice was in the limited level of disclosure obligations by foreign trusts set up in New Zealand. What is important to emphasize is not necessarily that the foreign trust regime itself is harmful, but that the inadequate disclosure requirements were enabling non-residents to take advantage of New Zealand's clean reputation, and to use this regime in a manner that was not intended. The use of foreign trusts by non-residents came to the fore following revelations in the Panama Papers disclosing New Zealand's involvement in facilitating alleged tax avoidance and evasion by overseas persons. The New Zealand government set up the Inquiry into Foreign

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37 For a recent contribution to the debate over a capital gains tax in New Zealand, *see* 21 NZ J. Taxn. L. & Policy 1 (2015) (special issue). A tax working group established by the government recommended a comprehensive CGT in its Feb. 2019 report. The proposal has been rejected by the New Zealand government on 17 Apr. 2019; *see* G. Robertson and S. Nash, *Govt responds to Tax Working Group report*, Media Release (17 Apr. 2019), available at http://taxpolicy.ird.govt.nz/news/2019-04-17-government-responds-twg-recommendations#statement (accessed 10 Apr. 2019).

38 OECD/G20, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2014 Deliverable* (OECD 2014), International Organizations' Documentation IBFD. New Zealand is not referred to in the OECD's 2017 progress report on preferential regimes. OECD/G20, *Harmful Tax Practices: 2017 Progress Report on Preferential Regimes – Inclusive Framework on BEPS: Action 5* (OECD 2017).

Trust Disclosure Rules in June 2016,[39] with the subsequent Shewan Report[40] making numerous recommendations to increase disclosure by foreign trusts. The vast majority of these recommendations were enacted in February 2017.[41] As a consequence, it is likely that there is no longer a "reasonable likelihood" that the foreign trust regime supports tax evaders.[42] New Zealand is now in a position where the OECD considers that its tax system has no "harmful preferential regimes", with one tax expert believing most New Zealand foreign trusts will be wound up.[43] Nevertheless, New Zealand can be described in one sense as being a foreign trust tax haven, in that it does not tax the foreign income on new migrants for a period of 4 years.[44]

New Zealand has an active unilateral (and bilateral) advance pricing agreement (APA) regime, as well as a comprehensive binding advance ruling regime for public, private and product rulings.[45] New Zealand has stated that it will disclose any rulings given by Inland Revenue that fall into any of the six categories highlighted as part of the BEPS Action 5 Final Report (Action 5),[46] namely:

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39 Establishment of the Government Inquiry into Foreign Trust Disclosure Rules, Notice 2106-2253, NZ Gazette 33 (2016).

40 The Treasury, J. Shewan, Government Inquiry into Foreign Trust Disclosure Rules (June 2016).

41 *See* NZ: Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act, 2017.

42 Shewan, *supra* n. 40, at para. 1.13.

43 E. Cadman, *This Haven for Billionaires Has a Murky Trust Issue*, Bloomberg (9 Feb. 2017), available at https://www.bloomberg.com/news/articles/2017-02-08/jho-low-s-private-jet-shines-light-on-new-zealand-s-murky-trusts. Foreign trusts will fall within the hybrid mismatch rules contained in the Tax Bill 2017 which will further reduce the attractiveness of having foreign trusts set up with New Zealand resident trustees.

44 *See further* http://www.ird.govt.nz/yoursituation-nonres/move-nz/temp-tax-empt-foreign-inc.html (accessed 10 Apr. 2019).

45 For the New Zealand binding rulings regime, *see* Part 5A of the Tax Administration Act 1994. Unilateral APAs are issued as a form of private binding ruling under NZ: Tax Administration Act, 1994, Part 5A. Most of New Zealand's bilateral APA work has been with Australia, although it has also completed bilateral APAs with Belgium, Canada, Japan, Korea (Rep.), Switzerland and the United States. New Zealand has not established any formal processes for obtaining an APA. This is on the basis that the number of requests is not high, and each case will be different, depending on a taxpayer's specific facts and circumstances.

46 OECD/G20, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2015 Final Report* (OECD 2015),

- rulings relating to preferential regimes;
- unilateral APAs or other cross-border unilateral rulings in respect of transfer pricing;
- cross-border rulings providing for a downward adjustment of taxable profits;
- PE rulings;
- related-party conduit rulings; and
- any other type of ruling agreed by the Forum on Harmful Tax Practices that, in the absence of spontaneous information exchange, gives rise to BEPS concerns.

This applies to past rulings issued on or after 1 January 2010 and which are still in effect on or after 1 January 2014. It also applies to rulings issued on or after 1 April 2016.

Prior to the BEPS Project, no harmful tax practices were identified by the OECD and New Zealand came through as "largely compliant" in its review by the OECD Global Forum. This reduced the amount of work that New Zealand has needed to comply with the 15 BEPS Actions, especially with respect to Action 5. The area of foreign trusts was subsequently revealed as an area where enhanced disclosure was necessary. While the changes to the disclosure rules for foreign trusts has already been enacted, the Tax Bill 2017 will catch foreign trusts as being "reverse hybrids" to prevent them being used for total non-taxation subject to a de minimis exemption.[47]

25.6. Implementation of transfer pricing suggestions (BEPS Actions 8-10 and 13) and mandatory disclosure rules (BEPS Action 12)

Inland Revenue published guidelines on transfer pricing in October 2000.[48] These provide guidance on the practical application of the legislative requirements for transfer pricing contained in sections GC 6 to GC 14, inclusive, of the ITA. Specifically, section GC 6(1) provides as follows:

> The purpose of this section and sections GC 7 to GC 14 is to substitute an arm's length consideration in the calculation of a person's net income if the person's net income is

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International Organizations' Documentation IBFD.

47 *Supra* n. 16, at p. 7

48 Inland Revenue, *Transfer Pricing Guidelines: A Guide to the Application of Section GD 13 of New Zealand's Income Tax Act 1994*, 10 Tax Information Bulletin 2, Appendix (2000).

reduced by the terms of a cross-border arrangement with an associated person for the acquisition or supply of goods, services, or anything else.

Since 2000, Inland Revenue has made two minor revisions to its administrative practice for services (namely increasing the threshold from NZD 100,000 to NZD 600,000, and again more recently to NZD 1 million). New Zealand does not intend to further update these guidelines, but rather, Inland Revenue will be applying the latest OECD Transfer Pricing Guidelines (OECD Guidelines) (2017).[49] The OECD Guidelines are considered to be consistent with New Zealand's transfer pricing law and income tax treaties. It is the view of Inland Revenue that no legislation will be required to give effect to any of the changes in the OECD Guidelines. This reflects Inland Revenue's interpretation of sections GC 6 to GC 14, especially section GC 13, which provides that the Commissioner has the power to determine arm's length amounts.

In March 2017, Inland Revenue released three government discussion documents, one of which concerned transfer pricing reform and permanent establishment avoidance.[50] Regarding permanent establishments (PEs), it proposed:

- the introduction of a PE anti-avoidance rule that would apply to multinationals with global turnover exceeding EUR 750 million (the BEPS threshold for large multinationals) and which structure their New Zealand and business operations to avoid having a PE in New Zealand. The proposed rule would deemed a non-resident entity to have a PE in New Zealand if a related entity carried on sales-related activities in New Zealand for the non-resident. The new rule would also apply to third-party channel-provider arrangements where a non-resident supplied goods or services to New Zealand customers in effective partnership with an independent New Zealand distributor;
- an amount of income would be deemed to have a source in New Zealand if New

49 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), International Organizations' Documentation IBFD.

50 Hon. Steven Joyce & Hon. Judith Collins, *BEPS: Transfer Pricing and Permanent Establishment Avoidance: A Government Discussion Document* (Mar. 2017); Hon. Steven Joyce & Hon. Judith Collins, *BEPS: Strengthening our interest limitation rules: A Government Discussion Document* (Mar. 2017); Hon. Steven Joyce & Hon. Judith Collins, *New Zealand's Implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS: A Government Discussion Document* (Mar. 2017).

Zealand has the right to tax that income under the PE article of any applicable tax treaty. New Zealand's model treaty PE article would be incorporated into domestic law as an additional source rule applying to non-residents to which no tax treaty applies;

- a non-resident's income would have a source in New Zealand if that income would have a New Zealand source and if the non-resident's wholly-owned group were treated as a single entity; and
- amendments to the life insurance source rules and foreign investment fund rules such that no deductions would be available for reinsurance of life policies if the premium income on the policies was not taxed in New Zealand, and to ensure that residents are subject to the foreign investment fund (FIF) rules in respect of any insurance policies not subject to New Zealand tax.

The New Zealand government announced in August 2017[51] that while it would proceed with the anti-avoidance provision for PEs, the rule would be more narrowly targeted at avoidance arrangements. The resulting provisions in the Tax Bill 2017, enacted by the New Zealand Parliament, appear to more closely follow Australia's multinational anti-avoidance law and the UK diverted profits tax. The New Zealand government has not ruled out adopting a diverted profits tax in future should the PE rule changes prove to be ineffective.

In respect of transfer pricing rules, the discussion document proposed:

- strengthening the rules so that they align with the OECD Guidelines and Australia's transfer pricing rules, namely:
    - the legal form would be disregarded if it did not align with the economic substance of the transaction (with Inland Revenue able to reconstruct a transaction);
    - where independent entities would not have agreed to a contractual condition, the transfer pricing rules would allow the condition, or the entire arrangement, to be set aside; and
    - the law would specifically refer to arm's length conditions and the latest OECD Guidelines;
- the burden of proof for demonstrating arm's length conditions would be shifted to the

[51] Joyce & Collins, *Government Announces BEPS Decisions*, *supra* n. 30.

taxpayer (although there would be no mandatory documentation requirement);

- the time bar for issuing transfer pricing assessments would be increased to 7 years (from 4 years) (consistent with Australia and Canada); and
- the transfer pricing rules would also apply to investors that "act together" or "act in concert", such as private equity investors.

These proposed changes are in line with the BEPS Actions 8-10 Final Report (Actions 8-10).[52]. Many of the submissions on the discussion document expressed concern that the proposals took a heavy handed approach; would introduce changes that would be difficult to enforce and apply (such as the proposed economic substance test); or significantly changed well established practice in New Zealand (such as the change in the burden of proof) and require multinationals to pay disputed tax earlier.[53] It was also unclear as to how these changes would interface with New Zealand's existing DTAs, notwithstanding the proposed multilateral treaty amendment initiative, which is discussed in section 25.7. The government subsequently announced in August 2017[54] that, while it will proceed with the proposals regarding transfer pricing recharacterization, the reconstruction provisions will be based on the test in the OECD Guidelines.

As New Zealand largely follows the OECD Guidelines,[55] the UN Manual on Transfer Pricing and the World Bank Handbook on Transfer Pricing are not directly applicable. New Zealand has very few tax treaties with developing countries;[56] the vast majority are with developed countries (most being members of the OECD) or the BRICS nations (Brazil, Russia, India, China and South Africa). Those treaties with developing countries are primarily situations where the jurisdiction is a significant trading partner of New Zealand. As New Zealand is not

52 OECD/G20, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Reports* (OECD 2015), International Organizations' Documentation IBFD.

53 NZLS, *Submission on: Base Erosion and Profit Shifting (BEPS) – Transfer Pricing and Permanent Establishment Avoidance: A Government Discussion Document* (1 May 2017); CA-ANZ, *Submission on: BEPS: Transfer Pricing and Permanent Establishment Avoidance: A Government Discussion Document* (18 Apr. 2017).

54 Joyce & Collins, *Government Announces BEPS Decisions*, *supra* n. 30.

55 *See* discussion in *supra* n. 50.

56 For further details on New Zealand's tax treaties, *see* http://taxpolicy.ird.govt.nz/tax-treaties (accessed 10 Apr. 2019).

a member of the European Union, none of the EU-specific changes are relevant.

Inland Revenue has advised that it will collect information required under the OECD country-by-country reporting regime from multinational groups with over EUR 750 million of annual consolidated group revenue. Inland Revenue believes that it has sufficient powers to meet the country-by-country reporting requirements without significant legislative amendment. Inland Revenue anticipates that the new country-by-country reporting requirements will affect only 20 New Zealand-headquartered corporate groups, and is contacting each group directly to ensure that they are adequately prepared for the new country-by-country reporting requirements.[57]

New Zealand already has automatic exchange of information in place. From 1 July 2017, financial institutions will need to begin meeting obligations under the OECD Common Reporting Standard (CRS) for the automatic exchange of information with respect to financial account information.[58] The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act received Royal assent on 21 February 2017. The approach of New Zealand as adopted in the legislation is essentially to incorporate the CRS directly into New Zealand law by reference, and to require the application of the CRS to be consistent with the Commentary on the OECD Model Tax Convention on Income and on Capital.[59,60]

Inland Revenue has introduced an annual questionnaire designed to collect information about debt financing and transfer pricing issues from certain international companies operating in New Zealand. This information will be used to assist with risk analysis and BEPS-related

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57 One of the authors (Sawyer) has undertaken research with a colleague from Queensland University of Technology into the preparedness of the tax profession and their multinational clients in Australia and New Zealand for country-by-country reporting. *See* K. Sadiq and A. Sawyer, "Country by Country Tax Reporting: A Critical Analysis of Enhanced Regulatory Requirements for Multinational Corporations", 36 Company and Securities Law Journal 7, pp. 570-586 (2009).

58 This gives effect to the OECD/G20 standard for automatic exchange of financial account information in tax matters.

59 For further information on the Common Reporting Standard, *see* http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/ (accessed 10 Apr. 2019).

60 Most recently, *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Models IBFD.

policy developments. This information will not be made public other than where financial reporting requirements under the International Financial Reporting Standards may require certain disclosures to be made.

The ability of Inland Revenue to access information and documents held by large multinationals offshore has been increased. A number of administrative rules will be introduced to give effect to these powers, including:

- where a large multinational does not cooperate with Inland Revenue, the latter may more readily issue a notice of proposed assessment (or other documents in a dispute resolution process) based on information it has available at the time;
- in disputes concerning transfer pricing, the amount of New Zealand-source income and the application of a tax treaty, any disputed tax must be paid earlier in the dispute process;
- tax payable by any member of a large multinational may be collected from any wholly-owned group member, or a related New Zealand entity falling under the new PE rules; and
- Inland Revenue will have the power to collect more information from large MNEs, including information about an MNE's various non-resident members.

In its announcement in August 2017,[61] the government stated that it will proceed with all of the proposed changes, including increasing Inland Revenue's powers to deal with "uncooperative" large multinationals, but will not require the tax to be paid in advance.

Under the Action 12 Final Report (Action 12),[62] New Zealand currently has no specific requirements or any plans to legislate for such disclosure requirements. While there are no mandatory disclosure rules (and no indication that any such rules are planned), Inland Revenue has, however, commenced issuing an annual international tax questionnaire to multinational enterprises to gather specific information. The international questionnaire is designed to collect key information about financing/debt and transfer pricing issues. It is only two pages long, with one page of key metrics and one page of mostly Yes/No-type questions,

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61 Joyce & Collins, *Government Announces BEPS Decisions*, *supra* n. 30.

62 OECD/G20, *Mandatory Disclosure Rules – Action 12: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD.

with the possibility to add comments. Guidance notes are provided with the questionnaire. Specifically, the information is intended to:[63]

- enhance Inland Revenue's risk assessment processes supported by the current Basic Compliance Package and Compliance Management processes that Inland Revenue already has in place. This is intended to enable Inland Revenue to provide greater certainty and further adapt its interventions to facilitate compliance for multinationals within New Zealand; and
- assist New Zealand in meeting its international obligations in relation to BEPS and further inform key tax policy decisions for New Zealand.

While New Zealand generally takes an open, consultative and transparent approach to tax and other policy developments, it takes a firm line on not disclosing information about specific taxpayers' tax affairs. This stance is largely due to the overarching secrecy obligations contained in Part 4 of the Tax Administration Act (1994). Disclosure by taxpayers of information to Inland Revenue is a statutory requirement when formal requests are made under sections 16 and 17 of that Act. However, this information would normally not be publicly disclosed unless there is a specific requirement to do so. Exceptions include certain penalties (such as for criminal evasion), or via the court phase of a tax dispute resolution process.

New Zealand does not have a formal constitution as such, but within its foundational documents (such as the New Zealand Bill of Rights Act (1990) and the Treaty of Waitangi[64]), there are a number of protected rights, although no specific right to privacy.[65] This "right to privacy", in a tax context is largely limited to the protections (and exceptions) set out in Part 4 of the Tax Administration Act (1994). The current proposals are unlikely to violate the limited protections, including privacy rules, in the Tax Administration Act (1994). Should

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63 *See further* http://www.ird.govt.nz/international/business/questionnaire/ (accessed 10 Apr. 2019).

64 NZ: New Zealand Bill of Rights Act, 1990, and NZ: Treaty of Waitangi Act, 1975, Schedule 1, referring to New Zealand's founding document of 1840.

65 While many specific rights are set out in the Bill of Rights Act (1990), there is no specific mention of a right to privacy. However, sec. 28 of that Act states as follows: "Other rights and freedoms not affected: An existing right or freedom shall not be held to be abrogated or restricted by reason only that the right or freedom is not included in this Bill of Rights or is included only in part".

New Zealand change its stance with respect to Action 12, the draft policy and legislation would need to be closely examined to ensure that it does not violate existing protections and privacy provisions.

In terms of Actions 8-10 and 12, New Zealand will continue to follow the OECD Guidelines but will not formally incorporate them into domestic tax law. The changes to the PE avoidance and transfer pricing rules will have been made a little more palatable with the government's announcement on 5 August 2017 to restrict their scope compared to what was initially proposed.[66] New Zealand is furthermore in the process of implementing country-by-country reporting, although it does not believe that any significant legislative change is required given that there are only 19 MNEs headquartered in New Zealand, each of which is closely followed by Inland Revenue. Finally, New Zealand does not have, nor does it propose to introduce, mandatory disclosure rules.

25.7. Implementation of the MLI: BEPS Action 15

As a member of the OECD and due to concerns about multinational tax avoidance, New Zealand worked actively with the OECD and G20 in the drafting of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). New Zealand signed the MLI[67] in early June 2017 in respect of all parts of that convention. Ideally, it wanted all of its existing 40 tax treaties to be covered treaties under the MLI unless:

- the other contracting state did not intend to sign the MLI; or
- an existing tax treaty is being renegotiated and the provisions of the MLI are expected to be included in the new tax treaty.

When signing the MLI, New Zealand originally designated that 36 of its 40 tax treaties would be covered agreements under the MLI. The four treaties excluded were those with Fiji, Samoa, Taiwan and the United States. Fiji is a signatory to the MLI, and a new treaty is being negotiated, which explains why New Zealand did not designate the existing Fijian treaty as a

[66] Joyce & Collins, *Government Announces BEPS Decisions*, *supra* n. 30.

[67] OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties IBFD.

covered agreement.

New Zealand has tax treaties with a number of states which it would like to be covered under the MLI, but these respective states have not signed the MLI as at 31 March 2019. They are the Philippines, Thailand and Vietnam. Taking into account that the Fiji tax treaty is not a covered agreement because a new tax treaty is under negotiation which is likely to be compliant with the MLI (as Fiji has already signed the MLI), only 33 tax treaties out of a possible 40 will – at this stage – be covered by the MLI.

New Zealand has deferred negotiating new tax treaties until the MLI has been signed and come into effect. New Zealand's last tax treaty to be signed was that with Samoa in July 2015. It is understood that a number of tax treaty negotiations are in progress, a number of which are with states that have signed the MLI.[68]

In March 2017, the New Zealand government released a discussion document[69] outlining how it would implement the MLI. The MLI will be treated domestically in the same way as any double tax agreement pursuant to section BH 1 of the ITA. This section has been amended to allow for multilateral conventions to be implemented in addition to bilateral double tax agreements.

After New Zealand signed the MLI, it was tabled in the New Zealand House of Representatives on 10 August 2017. This was followed by a national interest analysis, which is required of all treaties tabled in the House of Representatives. Following review by a Select Committee, an Order in Council will be submitted to the Cabinet for approval and – once in force – New Zealand will ratify the MLI by submitting a ratification instrument to the OECD depository. New Zealand will also confirm its list of reservations, notifications and

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68 New tax treaties are being negotiated with Luxembourg, Portugal, Saudi Arabia and the Slovak Republic; only Saudi Arabia has not signed the MLI. Replacement tax treaties are under negotiation with Canada, Fiji, Korea (Rep.), Norway and the United Kingdom – all of which have signed the MLI. *See* http://taxpolicy.ird.govt.nz/tax-treaties as at 23 Aug. 2017.

69 Inland Revenue (Policy and Strategy Group), *New Zealand's Implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS: An Officials' Issues Paper* (Mar. 2017). Submissions have been sought (and are now closed). A number of the proposals may in part depend upon the outcome of the consultation process on the other discussion documents dealing with BEPS-related issues.

choices.

The New Zealand government will not issue consolidated versions of its existing tax treaties that are modified by the MLI. This is consistent with their existing treatment of amending protocols to tax treaties that are negotiated from time to time. It has said that commercial publishers are free to produce consolidated versions if they wish, although such versions will obviously have no special legal standing. Fortunately, as New Zealand is an English-speaking country and all its tax treaties are in English, there will be no translation issues with implementing the MLI. In some cases, treaty partners may face translation issues, as some New Zealand tax treaties are in two languages, both of which are held to be authentic.

The MLI will come into effect and modify specific tax treaties once both parties to a tax treaty have signed and ratified the MLI. Therefore, existing treaties will be modified individually over a period of time as this process occurs. For withholding taxes, the changes arising from the MLI will take effect from 1 January of the following calendar year either beginning on or after the latest date on which the MLI comes into force for each of the parties to a covered tax treaty. For other income tax matters, it will apply to income years beginning on or after a 6-month period from the latest date on which the MLI comes into force for each of the parties to a covered tax treaty. At the moment, precise dates are not determinable, but New Zealand is seeking to negotiate to make modifications to its covered agreements.

It is unfortunate that it appears the MLI will apply to only 33 of New Zealand's 40 tax treaties. A number of key Asia-Pacific countries have not signed the MLI and their intentions with respect to the MLI are not entirely clear.

25.8. Specific issues regarding tax treaty provisions: BEPS Actions 2, 6, 7 and 14

New Zealand followed all of the substantive BEPS provisions in the MLI where they are relevant.[70] New Zealand has already adopted many of the BEPS Actions in its existing tax treaties, but on a selective basis, so that adopting the MLI will result in a more consistent

[70] For example, art. 5 MLI to strengthen the exemption method used to relieve double taxation, is not relevant to New Zealand, as it prefers to grant a foreign tax credit rather than an exemption to relieve international double taxation.

approach over all covered agreements than is the case now.

Not all New Zealand tax treaties contain a provision dealing with fiscally transparent entities such as partnerships and trusts. Only the treaties with Australia, Chile, Japan and the United States currently contain such a provision, and thus adoption of article 3 of the MLI will provide greater protection against tax avoidance using such entities for all its covered agreements. While most New Zealand treaties contain a residence tie-breaker clause for corporate entities, adoption of article 4 of the MLI will provide a more robust provision against tax avoidance arrangements using dual-resident companies.

New Zealand has not adopted a policy of including a limitation-on-benefits article in its tax treaties. Only its tax treaty with the United States contains such an article.[71] However, a number of its treaties contain limited anti-abuse provisions that apply in respect of two matters, namely:

- eligibility to receive tax sparing benefits;[72] and
- eligibility for zero withholding tax on intercompany dividends where the voting interest in the subsidiary company is above a certain level.[73]

In the case of tax-sparing benefits, the anti-abuse clause is more akin to a principal-purpose test, while in the case of eligibility for the exemption from withholding tax for intercompany dividends, the anti-abuse provision is more akin to a limitation-on-benefits article that is based on several so-called black-letter tests.

New Zealand has elected to adopt article 7(4) of the MLI using a principal-purpose test. The

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[71] *Convention between the United States of America and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* art. 16 (23 July 1982) (amended through 2008), Treaties IBFD, as modified by art. 11 Second Protocol to this treaty signed 1 Dec. 2008.

[72] Protocols appended to the China-New Zealand Income Tax Treaty 1986 (new 2019 DTA not in force), Fiji-New Zealand Income Tax Treaty 1976, India-New Zealand Income Tax Treaty 1986 and Korea (Rep.)-New Zealand Income Tax Treaty 1981. The New Zealand-Singapore Income Tax Treaty 2009 and the New Zealand-Vietnam Income Tax Treaty 2013 contain similar provisions in their art. 23 (Relief of Double Taxation) where the tax sparing provisions are found.

[73] For Australia and the United States, the threshold is 80% or greater voting power, while for Hong Kong the threshold has been set lower, at 50%.

reason for this choice, explained in an earlier issues paper,[74] is that the principal-purpose test is very similar to New Zealand's GAAR found in section BG 1 of the ITA. The New Zealand GAAR has been successfully invoked by the Commissioner in response to a variety of tax avoidance schemes, and thus there is confidence in New Zealand as to such an approach.[75] Under the principal-purpose test, treaty benefits will be denied if the principal purpose of an arrangement is to secure tax treaty benefits.

New Zealand will follow the arbitration provisions in articles 23(5) and 24(2) of the MLI. Currently, very few New Zealand tax treaties allow for arbitration of disputes that are not resolved under the mutual agreement procedure. However, it has reserved its right for Part IV of the MLI not to apply in respect of covered agreements where the other contracting jurisdiction has made a reservation pursuant to article 23(6). In respect of article 24(2), it has reserved the right for that provision to apply only to covered agreements that will apply article 23(2). New Zealand has also entered a general reservation to the arbitration provisions in Part VI of the MLI to exclude from those provisions cases involving the application of New Zealand's GAAR found in section BG 1 of the ITA.

74 *Supra* n. 69.

75 *See* e.g. the *Alesco* (2013) case, discussed in sec. 25.2.