



# Multinational Enterprises

Compliance Focus 2019



**Inland Revenue**  
Te Tari Taake



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# Contributing to New Zealand

**“The tax we collect from significant enterprises accounts for almost 10% of total annual tax revenue. I am confident that the anti-base erosion and profit shifting measures we have implemented, together with our refreshed compliance approach, will continue to protect the New Zealand tax base and ensure multinationals pay their fair share.”**



I am proud of the milestones we have achieved during the last three years, as we continue to successfully transform Inland Revenue.

With the increasing complexities of globalisation, we are actively participating in international solutions to facilitate compliance and have implemented the automatic exchange of financial account information.

In June last year, the Government passed legislation which ensures multinational enterprises (MNEs) pay tax based on the actual economic activity they carry out in New Zealand. This legislation improves the fairness of the tax system and helps preserve its integrity. I am especially pleased with the level of engagement we have had from the business community to help us design robust policies that meet international standards and reflect the New Zealand context. Internationally, New Zealand continues to rate highly for integrity and ease of doing business.

We have recently refreshed our compliance approach. This refresh explicitly outlines our objective - to collect the *“right amount of tax at the right time through the right channels”*.

Our commitment to our customers is that we will prioritise our efforts and focus mainly on prevention. We will be pragmatic and proportionate in reaching solutions to problems.

Our approach recognises the new anti-BEPS measures and the resulting restructuring of multinationals. It is great to see already the desired behavioural shift from these new measures. MNEs are becoming more aware of their reputations and of how aggressive tax positions can tarnish their brands.

Designing and delivering services and systems that facilitate compliance in a customer-centric manner remains a priority for Inland Revenue. We continue working to ensure that individuals and businesses that are conducting cross-border transactions pay their fair share of tax. To this end, we are working actively with other OECD jurisdictions on a multilateral agreement on how best to tax the digital economy.

I want to thank all multinational enterprises and representative organisations for their professional input and willingness to work with us as we collectively contribute to the social and economic well-being of New Zealand.

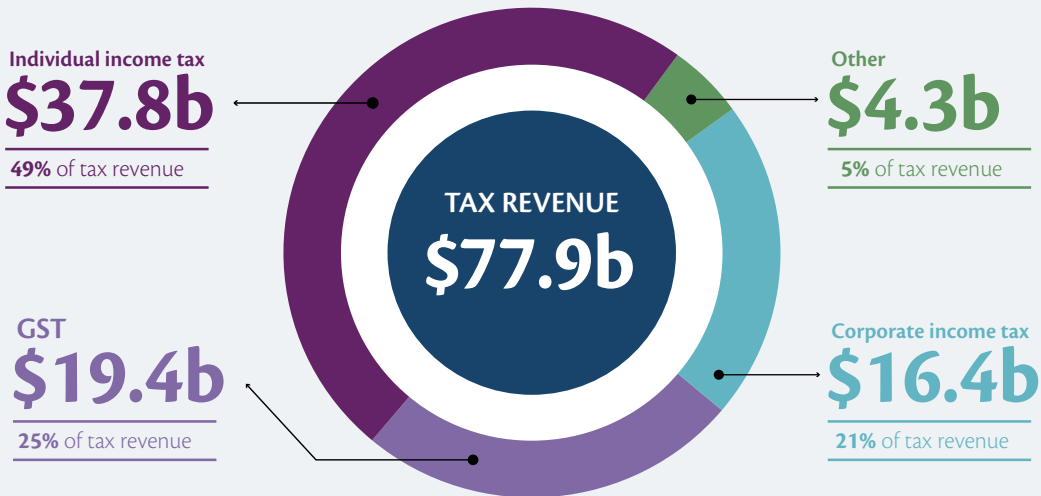
A handwritten signature in black ink that reads "Naomi Ferguson". The signature is written in a cursive, flowing style.

**Naomi Ferguson**  
Commissioner of Inland Revenue  
1 NOVEMBER 2019

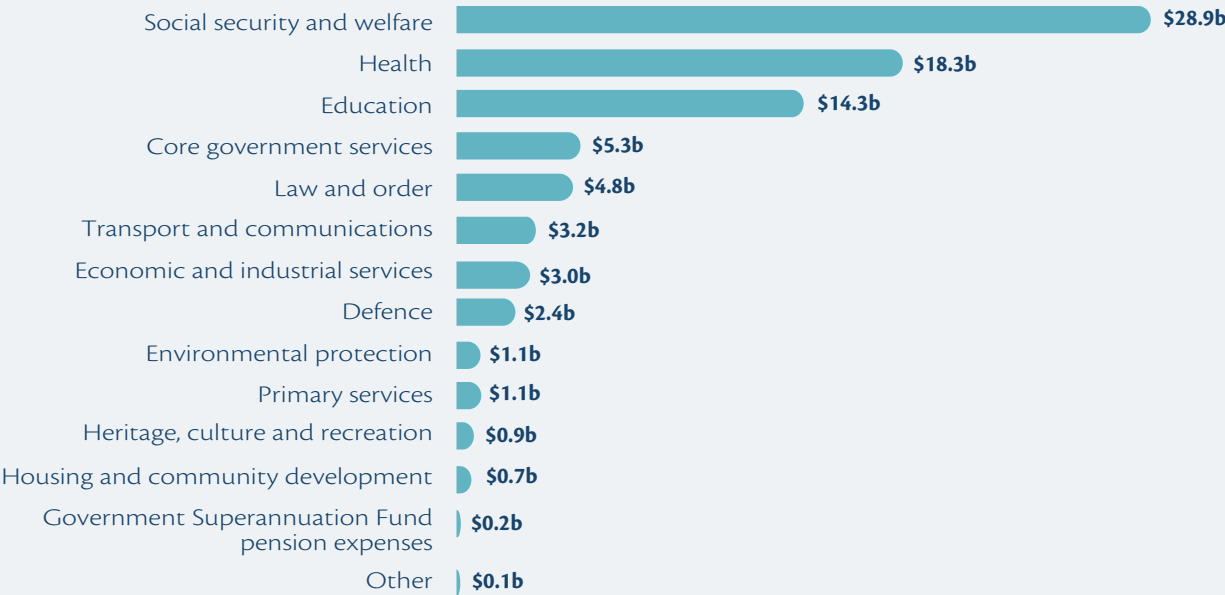
# What Your Taxes Pay For

## All New Zealanders benefit from tax

The money we collect helps pay for the public services all New Zealanders benefit from, such as education, transport and healthcare. One of our responsibilities is to make sure the Government has funding for these essential services. In 2018–19, we collected \$77.9b of tax revenue to help fund government programmes.



In 2018-19 the Government expected to spend in the following areas:



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# New Zealand Context

New Zealand individuals and businesses are becoming more involved in international trade and investment and we collect a substantial amount of corporate tax (21% of the overall tax take). This reflects the consistent and strong emphasis placed by New Zealand on tax policy and administration to ensure the integrity of the corporate tax base.



A greater proportion of corporate tax, together with the fact that a relatively small number of companies account for most of it, means that New Zealand remains vigilant on corporate tax base erosion.

**Significant enterprises (SEs) with an annual turnover of at least \$80m account for approximately \$7.3b worth of corporate tax, which is approximately 45% of the total corporate tax base. More than half of these SEs are multinational enterprises.**

MNEs are a significant force in New Zealand's economic environment and protecting New Zealand's tax revenue means we need to look at compliance internationally as well as domestically. The increasing complexity of global business requires us to be actively involved in international solutions to facilitate compliance. Our work in this area means New Zealand continues to be an attractive place for people to do business and invest.

Inland Revenue plays a unique role in making New Zealand a great place to live, work and raise a family. It is important that we are ready to maintain this role in a changing world. The success of our Business Transformation programme, which is well-advanced, is helping us to do this. We want to ensure that tax is more simple, open and certain for our customers and that we have the capabilities we need to meet their needs.

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# The Last Three Years

Our 2016 Multinational Enterprises Compliance Focus Document aimed to make tax compliance more transparent for businesses and to give them more certainty. In this 2019 update, we are once again aiming to provide transparency and certainty.



Considerable progress has been made in the last three years as we move through the various stages of our Business Transformation programme. At the same time, we are meeting our international commitments and working with other jurisdictions to transform the international tax scene.

Since 2016, we have successfully implemented BEPS minimum standards such as country-by-country reporting and exchange of tax rulings. We have signed up to the OECD's multilateral instrument (MLI), made our dispute resolution mechanisms more effective, and introduced a range of new anti-BEPS measures that ensure New Zealand responds appropriately to domestic and international threats to its tax base.

The BEPS Action Plan recommendations have already brought about major changes in the global taxation scene. New Zealand's anti-BEPS measures have given Inland Revenue more administrative powers, encouraging MNEs to respond adequately to information requests and to be more open and transparent.

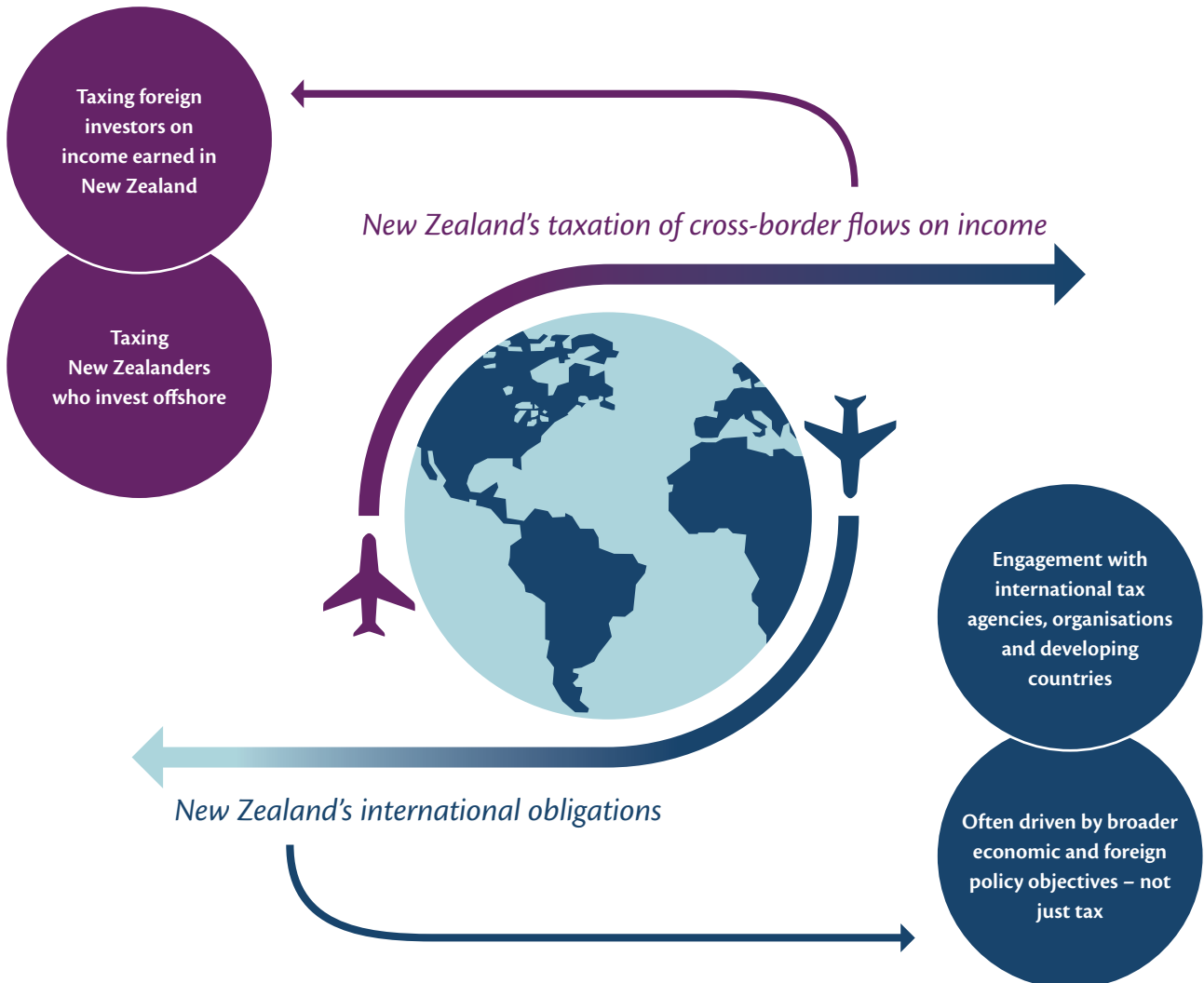
Inland Revenue is subject to rolling peer reviews led by the OECD and we are pleased to report that New Zealand is meeting the international standards, helping us maintain a global reputation we can all be proud of and enjoy.

We have successfully increased our coverage of MNEs by expanding the SE population to all groups with an annual turnover greater than \$80m and all foreign-owned SEs with an annual turnover in excess of \$30m. This has seen the population expand from 600 to just under 1000 groups. They are reviewed annually and risk-assessed on information they provide. Based on the amount of tax they pay, the top 50 corporate customers continue to receive additional attention through one-on-one account management.

As a result of this expansion, we have more than doubled the population that receives the international questionnaire. We would like to thank all those multinationals and their representatives who work closely with us every year to achieve a 100% response rate over the last five years. The responses we received helped shape our anti-BEPS measures and continue, cost-effectively, to inform our customer-centric compliance approach for MNEs.

# International Tax Strategy

Our international tax strategy aligns well with Inland Revenue's Compliance Model which outlines the principles of how we should interact with our customers.



## HIGHLIGHTS FROM THE INTERNATIONAL QUESTIONNAIRE



**623**

foreign-owned groups

### Ultimate ownership (largest jurisdictions)



**131**

USA



**127**

Australia



**68**

Japan



**33**

UK



**32**

GERMANY



**67%**

of our foreign-owned groups over \$30m are subject to CbC reporting



**Through the integration of this strategy, we expect to achieve a future state with the following characteristics:**

- An appropriate compliance environment that supports New Zealand businesses operating globally and assists MNE operations in New Zealand by working with other tax authorities and key business interests to facilitate trade and investment.
- A New Zealand economy made more productive by a level playing field for compliant taxpayers, fewer competitive distortions and the lowest possible compliance costs.
- Increased assurance to the community that Inland Revenue is tackling aggressive tax planning by multinationals.
- Continued active collaboration with international organisations to deliver the best outcomes for New Zealand.



**Inland Revenue's Compliance Model**

**Facilitating international tax compliance**

Inland Revenue and SEs have an important relationship in New Zealand's overall revenue collection landscape. More than half of them are foreign-owned, with a further 25% involved in international operations mainly through controlled foreign companies. In 2018-19, this customer segment paid approximately \$7.3b in corporate tax, which is almost 45% of the total corporate tax collected last year.

New Zealand's compliance objective for multinationals is to collect the "right amount of tax at the right time through the right channels".

Our commitment to our customers is that we will prioritise our efforts and focus mainly on prevention. We will be pragmatic and proportionate in reaching solutions to problems.

Our refreshed compliance approach recognises the new anti-BEPS measures in effect from 1 July 2018 and the consequent restructuring of MNEs. The following principles define the way we want to work with multinational enterprises to facilitate international tax compliance.

**PRIORITISATION**

- We will prioritise our work based on tax risk and materiality, keeping taxpayer compliance costs and Inland Revenue's administrative costs as low as possible.

**PREVENTION**

- We will embrace the "right from the start" concept and, as far as possible, our primary focus will be on working co-operatively with MNEs to prevent BEPS. We will capitalise on our recent law reform to drive behavioural change in any MNEs inclined to indulge in aggressive tax planning practices.

**PRAGMATIC**

- We will be reasonable and realistic, taking a pragmatic approach overall, especially in respect of transfer pricing given the various limitations in data and methodologies.

**PROPORTIONATE**

- We will respect the additional dimensions presented by the Mutual Agreement Procedure in our tax treaties as well as the global nature of MNE operations.

**Largest industries**

**24%** Distributors/Wholesalers

**16%** Manufacturing (excluding food and beverage)

**8%** Food and beverage

**27%** Groups that paid royalties, licence or franchise fees to non-resident associated persons (33% in 2014)

**3%** Groups that made material structural changes which resulted in a reduction of business functions, assets held and risks borne by the New Zealand operations (10% in 2014)

**6%** Groups that had financial derivative transactions with non-resident associated persons

# Our Compliance Approach

Over two-thirds of world trade involves MNEs and, according to the OECD, over 60% of international trade takes place between related parties. This gives MNEs an unprecedented ability to engineer their finances for the greatest tax advantage.

We have endorsed the OECD's concept of an enhanced relationship with significant enterprises. The relationship concept is based on risk management, fair, open and responsive administration, and greater transparency by taxpayers. The hypothesis is that "taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs". We endeavour to nurture relationships with taxpayers and their advisers and establish an environment that welcomes full and frank dialogue.

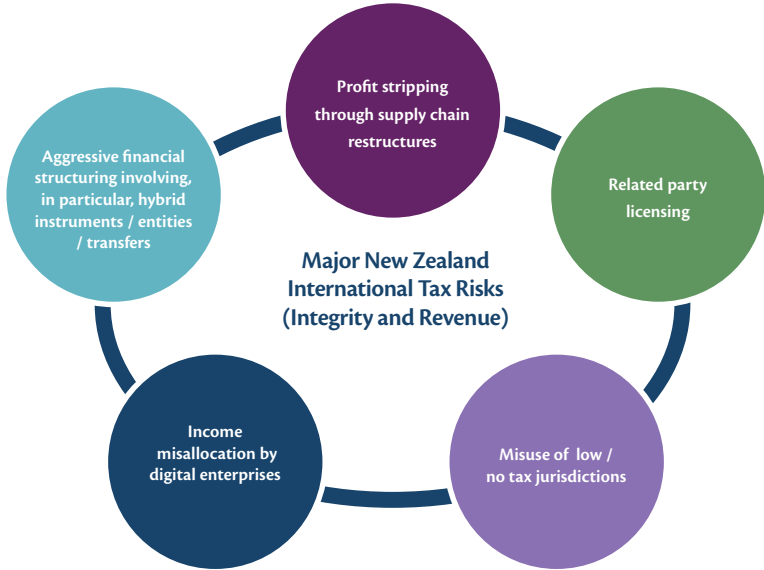
We closely monitor all significant enterprises with a turnover greater than \$80m and all foreign-owned corporates with a turnover in excess of \$30m. These SEs are required to submit a Basic Compliance Package (BCP) every year. The BCP comprises a group structure, financial statements, and tax reconciliations. The information is run through our risk rules engine and based on the assigned rating, the SE may undergo further in-depth examination (including risk reviews and audits).

Foreign-owned groups are also required to complete an annual international questionnaire (IQ) which is designed to collect key information about financing/debt and transfer pricing issues. The

intelligence derived from the information collected informs our strategic and operational risk assessment processes relating to these businesses in New Zealand.

As part of implementing Action 13 of the BEPS Action Plan, we commenced the exchange of country-by-country (CbC) reports last year. The standard applies to MNEs with annual consolidated group revenue of over EUR 750m (approximately NZ\$1.3b). In the year to 31 December 2018, we received 1402 CbC reports. The reports we are receiving are not only for SEs but also for the small to medium enterprises and microbusinesses in New Zealand. The reports contain a range of important information such as gross revenues, profit/loss before income tax and employee numbers.

The BCP, IQ and account management processes already in place, combined with the CbC reports, mean we can give multinationals greater certainty and tailor our interventions to facilitate their compliance with tax law in New Zealand.



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# Monitoring the Implementation of Anti-BEPS Measures

It is widely accepted that the anti-BEPS measures will continue to drive significant changes in the global tax landscape as countries implement them.

Inland Revenue aims to head off non-compliance before it occurs, by close monitoring, advance pricing agreements (APAs) and practical guidance to allow MNEs to better self-manage their financing and transfer pricing risks.

APAs lock in compliant outcomes by agreeing on the criteria for transfer prices in advance of transactions occurring. They can eliminate the need for potentially costly post-lodgement reviews and audits. They are not only a faster and clearer route to multilateral tax certainty, but also give the wider community more confidence in the compliance of MNEs.

The IQ has been critical in informing our risk picture as well as the new anti-BEPS measures. We have also used all the intelligence we hold on SEs, especially MNEs, to identify the groups that are impacted by the anti-BEPS measures and develop an international monitoring framework (IMF) to actively track them. We can see already a global tax reset. Behavioural changes are taking place with MNEs adjusting supply chains, locations of intangibles, financing arrangements and contracting practices.

## IMF covers the following key areas:



The digital economy



Transactions with low tax jurisdictions



Restructuring



Debt / capitalisation



Royalties

In the coming year we will be asking for more information and clarification of changes in MNEs' tax affairs to give us a clearer view of the impact of the new anti-BEPS measures. It will also help us design tailored interventions where behavioural change has not taken place.

We look forward to working cooperatively with multinationals and their representatives as we continue to provide greater certainty and facilitate international tax compliance in New Zealand.

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# Corporate Tax Governance



## OECD Guidance

Compliance begins with the right “tone from the top” being set by directors and senior management.

The *OECD Guidelines for Multinational Enterprises* are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide non-binding principles and standards for responsible business conduct in a global context consistent with applicable laws and recognised international standards.

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**Specifically, in respect of taxation matters, the Guidelines emphasise the importance of tax governance:**

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*“102. Enterprises’ commitments to co-operation, transparency and tax compliance should be reflected in risk management systems, structures and policies. In the case of enterprises having a corporate legal form, corporate boards are in a position to oversee tax risk in a number of ways. For example, corporate boards should proactively develop appropriate tax policy principles, as well as establish internal tax control systems so that the actions of management are consistent with the views of the board with regard to tax risk. The board should be informed about all potentially material tax risks and responsibility should be assigned for performing internal tax control functions and reporting to the board. A comprehensive risk management strategy that includes tax will allow the enterprise to not only act as a good corporate citizen but also to collectively manage tax risk, which can serve to avoid major financial, regulatory and reputation risk for an enterprise.” (page 61)*

 [www.oecd.org/daf/inv/mne/48004323.pdf](http://www.oecd.org/daf/inv/mne/48004323.pdf)

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The Guidelines are the only multilaterally agreed and comprehensive code of responsible business conduct that governments, including New Zealand, have committed to promoting.

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# From The Top Down...

## Checklist for boards of directors of New Zealand companies

1	Does the board have a well-documented overarching tax strategy?	<input type="checkbox"/>
2	Is this strategy actually followed in practice by the company's management?	<input type="checkbox"/>
3	Is the strategy and its implementation regularly reviewed and updated?	<input type="checkbox"/>
4	Does the company have a tax control framework to manage day-to-day tax risks?	<input type="checkbox"/>
5	Is senior management confident in the capacity and capability of the systems, procedures and personnel in place to achieve overall company tax compliance?	<input type="checkbox"/>
6	Is the tax or finance team on top of all relevant law changes (such as the anti-BEPS measures, the Common Reporting Standard and revisions to tax treaties)?	<input type="checkbox"/>
7	Does management report regularly to the board on potentially material tax issues and risks?	<input type="checkbox"/>
8	Has the operation of the tax control framework been tested independently in the last three years?	<input type="checkbox"/>
9	Is a clear statement made in the company's annual report as to tax governance?	<input type="checkbox"/>
10	Is annual reporting of tax payments and provisions sufficiently transparent for all relevant stakeholders to fully understand the company's overall tax position in New Zealand?	<input type="checkbox"/>

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See Co-operative Tax Compliance:  
Building Better Tax Control  
Frameworks at:

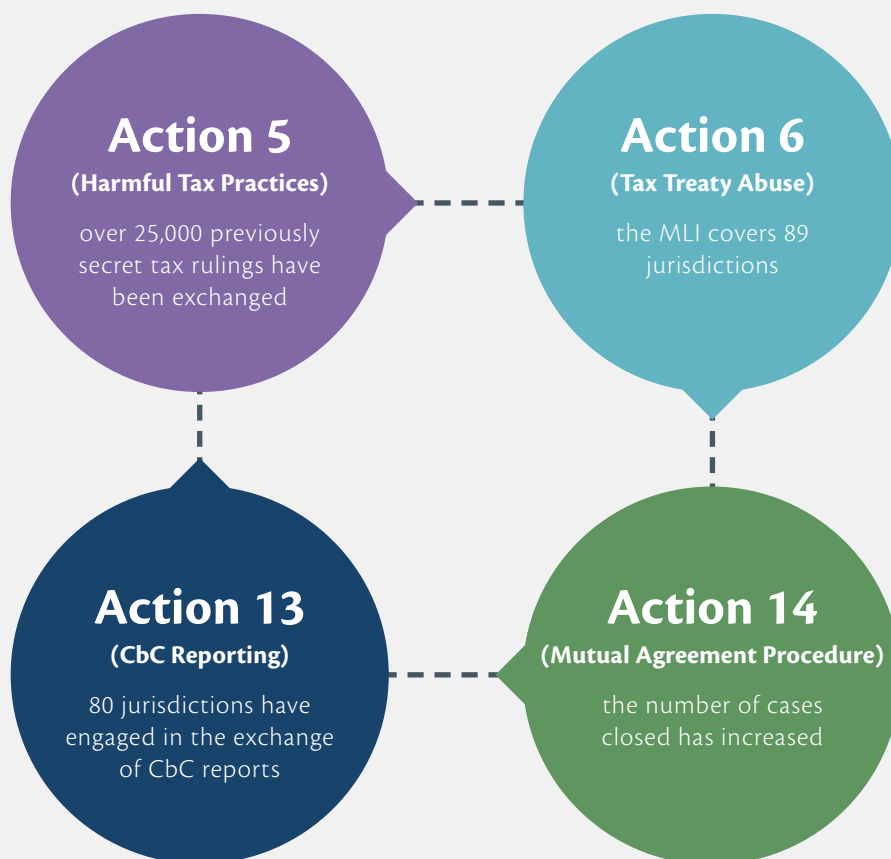


[www.oecd.org/tax/co-operative-tax-compliance-9789264253384-en.html](http://www.oecd.org/tax/co-operative-tax-compliance-9789264253384-en.html)

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# International Progress

The OECD/G20 Inclusive Framework has over 130 members representing some 95% of global gross domestic product. Members are required to implement four minimum standards, resulting in major legal and practical changes:



According to surveys and feedback from tax practitioners, a significant percentage of multinationals are implementing restructurings, revising their tax planning and changing the location of their investments to fall in line with the new environment.

## Monitoring Implementation

Each of the four BEPS minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field. New Zealand has committed to implement the minimum standards and has been subject to peer reviews covering these minimum standards.

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# New Zealand's Implementation of Anti-BEPS Measures



Prior to the implementation of the BEPS recommendations, New Zealand had some of the strongest tax base protection rules in the world. New Zealand has implemented the great majority of the BEPS recommendations, further strengthening our tax laws to protect against profit shifting by multinational enterprises. Action taken has included ensuring our transfer pricing laws reflect world's best practice, implementing country-by-country reporting, adopting a range of new tax treaty rules through the multilateral instrument (MLI), and introducing new measures to prevent tax avoidance through hybrid/branch mismatches and related-party financing arrangements. These measures (together with our pre-existing law) address all of the BEPS issues identified by the OECD.

Explanations of the new measures can be found in *Tax Information Bulletin* Vol 31 No 3 April 2019. Special reports on each measure, which mirror the bulletin, and changes since April 2019 can be found on our policy website.

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**“It is not in the interest of New Zealand taxpayers if multinational companies avoid paying taxes here. The changes address the problem of companies operating cross-border and using aggressive tax structuring to reduce the tax they pay. These changes enjoy the unanimous support of Parliament and are possible thanks to the work of MPs from all political parties, as well as valuable advice from tax professionals and useful submissions from members of the public. We will have a better, fairer tax system as a result of these changes.”**

**Hon Stuart Nash**

MINISTER OF REVENUE, 27 JUNE 2018

# New Zealand's Progress

BEPS Action Plan	OECD recommendations	NZ law prior to anti-BEPS measures	NZ's responses to OECD recommendations
<p><b>1</b></p> <p>Address the tax challenges of the digital economy</p>	<p>The report identified issues raised by the digital economy and possible actions to address them.</p> <p>It made recommendations on GST but did not generally recommend fundamental changes to the international income tax framework.</p>	<p>Generally consistent with existing international tax norms.</p>	<p>New Zealand imposed GST on online services from 1 October 2016 and has enacted new GST rules covering online sales of low value goods to apply from 1 December 2019.</p>
<p><b>2</b></p> <p>Neutralise the effects of hybrid mismatch arrangements</p>	<p>Recommendations regarding the design of domestic rules.</p> <p>Changes to the OECD Model Tax Convention and MLI to address hybrid entities.</p>	<p>Domestic law and DTAs already contained some targeted anti-hybrid mismatch rules.</p>	<p>New Zealand enacted comprehensive domestic hybrid mismatch rules based on OECD recommendations in 2018.</p> <p>New Zealand also adopted MLI provisions to strengthen DTAs.</p>
<p><b>3</b></p> <p>Strengthen controlled foreign company rules</p>	<p>Recommendations regarding the design of domestic rules.</p>	<p>Generally consistent with existing international tax norms.</p>	<p>No proposal to change controlled foreign company rules.</p>
<p><b>4</b></p> <p>Limit base erosion via interest deductions and other financial payments</p>	<p>Recommendations regarding the design of domestic rules, with a preference for the EBITDA approach.</p>	<p>Generally consistent with existing international tax norms.</p>	<p>New Zealand improved its rules in 2018 by introducing restricted transfer pricing rules for interest on related-party debt and requiring adjustment for "non-debt liabilities" in the thin capitalisation rules.</p>
<p><b>5</b></p> <p>Counter harmful tax practices more effectively, taking into account transparency and substance</p>	<p>Finalise review of member country regimes. Expand participation to non-OECD members and revision of existing criteria.</p>	<p>New Zealand's laws are already robust - no harmful tax practices identified.</p>	<p>New Zealand has implemented the requirements to exchange summaries of binding rulings and advance pricing agreements as recommended by OECD.</p>
<p><b>6</b></p> <p>Prevent treaty abuse</p>	<p>Changes to the OECD Model Tax Convention and changes to DTAs through the MLI to insert a general anti-avoidance provision called a "principal purpose test".</p>	<p>New Zealand's anti-avoidance law is generally strong, but the MLI presented an opportunity to further strengthen the law.</p>	<p>New Zealand has adopted the principal purpose test through signing the MLI.</p>
<p><b>7</b></p> <p>Prevent the artificial avoidance of permanent establishment status</p>	<p>Changes to the OECD Model Tax Convention and changes to DTAs through MLI to prevent PE avoidance.</p>	<p>New Zealand's PE definition is generally based on the existing OECD and UN models.</p>	<p>New Zealand has implemented OECD best practice standards for a number of DTAs by signing the MLI.</p> <p>New Zealand also introduced a new anti-avoidance rule in 2018 for large multinationals that structure to avoid having a PE in New Zealand and are not subject to the OECD's best practice PE definition.</p>



BEPS Action Plan	OECD recommendations	NZ law prior to anti-BEPS measures	NZ's responses to OECD recommendations
<p><b>8 to 10</b></p> <p>Ensure transfer pricing reflects economic substance</p>	<p>Changes to the OECD Transfer Pricing Guidelines.</p>	<p>New Zealand currently applies the OECD Transfer Pricing Guidelines.</p>	<p>New Zealand has made changes to domestic legislation to follow the revised OECD Transfer Pricing Guidelines.</p>
<p><b>11</b></p> <p>Establish methodologies to collect and analyse data on BEPS and the actions to address it</p>	<p>Recommendations regarding data to be collected and methodologies to analyse BEPS.</p>	<p>New Zealand collects and analyses certain data on BEPS as a matter of course.</p>	<p>In 2015, Inland Revenue implemented an annual international questionnaire that collects key data to assess BEPS risks.</p> <p>BEPS disclosures are required to be made with tax returns from 2019.</p>
<p><b>12</b></p> <p>Require taxpayers to disclose their aggressive tax planning arrangements to revenue authorities</p>	<p>Recommendations regarding the design of domestic disclosure rules.</p>	<p>No requirement under current law to disclose aggressive tax planning arrangements, however the combination of our strong anti-avoidance rules and the binding rulings and penalties regimes, incentivise disclosure.</p>	<p>No law reform planned but existing law incentivises disclosures.</p> <p>Taxpayers will often apply for binding rulings on potentially aggressive transactions to obtain certainty as to the tax treatment especially in light of our strong anti-avoidance law.</p> <p>Penalties on aggressive transactions are reduced for early disclosure of such arrangements.</p>
<p><b>13</b></p> <p>Re-examine transfer pricing documentation</p>	<p>Changes to OECD Transfer Pricing Guidelines and recommendations regarding the design of domestic rules, including country-by-country reporting.</p>	<p>New Zealand currently applies the OECD Transfer Pricing Guidelines but does not have a formal programme for collection of transfer pricing documentation.</p>	<p>Inland Revenue has implemented CbC reporting.</p>
<p><b>14</b></p> <p>Make dispute resolution mechanisms more effective</p>	<p>Recommendations on operational minimum standards and best practices for dispute resolution.</p>	<p>New Zealand has strong dispute resolution systems but does not currently allow taxpayers to approach the competent authority of <i>either</i> DTA partner for resolution of a dispute (the taxpayer must approach the authority in their home country) and does not generally offer arbitration of any disputes between authorities.</p>	<p>New Zealand has implemented OECD recommendations on dispute resolution by signing the MLI. In particular, New Zealand will allow taxpayers to approach the competent authority of either DTA partner in a treaty dispute and will also provide for arbitration of any disputes between authorities.</p> <p>Inland Revenue has issued guidance on the mutual agreement procedure.</p>
<p><b>15</b></p> <p>Develop the MLI to strengthen DTAs</p>	<p>The MLI implements substantive recommendations made in OECD's Action 2, 6, 7 and 14 reports.</p>	<p>New Zealand has a network of 40 DTAs.</p> <p>Some of the MLI provisions are already included in a few DTAs.</p>	<p>New Zealand signed and ratified the MLI in 2018.</p> <p>A number of DTAs have been modified in 2019 as a consequence.</p>

# Transfer Pricing

Transfer pricing rules guard against multinationals using related-party arrangements to shift profits offshore. The rules require the profits from these arrangements to be determined using the arm's length conditions, including price, which unrelated parties would agree to use.

The overall objective of the BEPS Action Plan for transfer pricing is to see operational profits allocated appropriately to the significant economic activities which generate them. As a result, changes have been made to more than half of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017* with four key chapters fully revised.

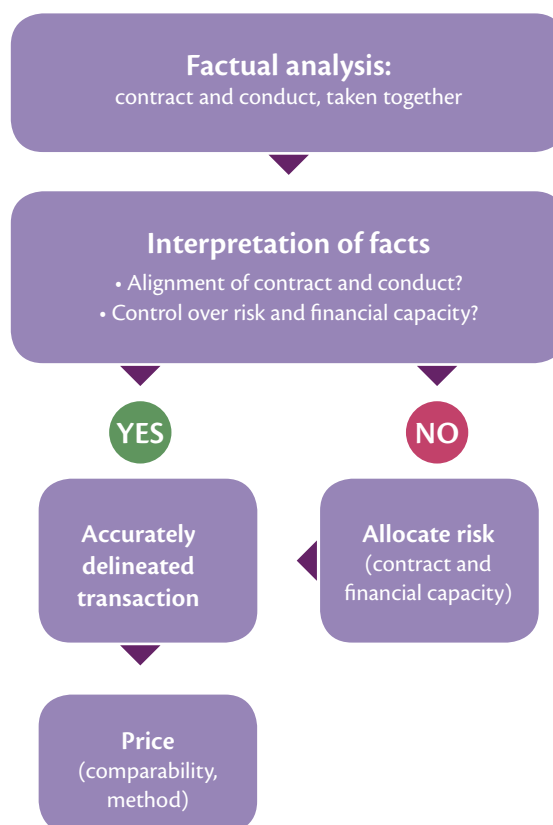
## The OECD has noted that this new guidance ensures that:

- actual business transactions undertaken by associated enterprises are identified, and transfer pricing is not based on contractual arrangements that do not reflect economic reality;
- contractual allocations of risk are respected only when they are supported by actual decision-making;
- capital without functionality will generate no more than a risk-free return, assuring that no premium returns will be allocated to cash boxes without relevant substance; and
- tax administrations may disregard transactions which are commercially irrational.

## New Zealand's transfer pricing rules have been amended to ensure alignment with the new OECD guidance and remain effective at combatting BEPS. The following key amendments have been made:

- The economic substance and actual conduct of the parties, along with the legal contract, will inform the transfer pricing analysis. In certain circumstances, the economic substance and actual conduct will have priority over the terms of the legal contract. This is achieved by requiring the transfer pricing transaction to be "accurately delineated". (See flow chart.)
- Where a transfer pricing arrangement is not commercially rational because it includes unrealistic terms that unrelated parties would not be willing to agree to, the transaction may be disregarded and, if appropriate, replaced.

## Accurate Delineation



**Other changes have been made to strengthen Inland Revenue’s ability to monitor and enforce the new transfer pricing rules. These changes include:**

- Putting the onus of proof on the taxpayer for providing evidence (such as documentation) that their transfer pricing positions are correct (that is, they are determined using arm’s length conditions).
- Allowing Inland Revenue to extend the time bar for assessing transfer pricing issues to seven years, in those cases where Inland Revenue has notified the taxpayer that a tax audit or investigation has commenced within the usual four-year-time bar.
- Additional powers for Inland Revenue to request information from large multinational groups in order to assist a tax investigation of the relevant multinational.

**Transfer pricing rules have also been extended to those not usually regarded as associated parties such as non-resident investors that act in concert to effectively control a New Zealand entity, in particular private equity structures. The new transfer pricing rules:**

- place increased importance on people and local New Zealand functions;
- focus on key decision-makers, where they are located, their decisions made with regard to risk, and their financial backing; and
- limit profits associated with legal ownership alone of contractual rights and intangibles.

**Documentation**

As the burden of proof for transfer pricing matters rests with the taxpayer, a lack of adequate documentation may make it difficult for a company to rebut an alternative arm’s length transfer price proposed by Inland Revenue. In the event of a transfer pricing adjustment being imposed, a lack of adequate documentation is also likely to result in penalties.

Checklist		
1	Do you know the nature and extent of your cross-border associated party transactions?	<input type="checkbox"/>
2	If material, do you have documentation in support of the transfer prices and is this documentation kept updated?	<input type="checkbox"/>
3	In compiling this documentation, have you critically evaluated all intercompany agreements?	<input type="checkbox"/>
4	Does the documentation explain: <ul style="list-style-type: none"> <li>• value adding functions of various parties to arrangements?</li> <li>• actual conduct of the parties?</li> <li>• how key risks are managed and controlled by the parties?</li> </ul>	<input type="checkbox"/>
5	Has your local management and finance function been fully involved in the documentation process and signed off the factual analysis, as well as the final outcomes?	<input type="checkbox"/>
6	Have you given due consideration to applying for an advance pricing agreement?	<input type="checkbox"/>

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# Transfer Pricing Simplification Measures

New Zealand's transfer pricing rules have always been about striking a balance between protecting the tax base and containing compliance costs. We have implemented a range of simplification measures targeted at reducing compliance costs in situations that are likely to present a low transfer pricing risk.

## Low Value-Adding Intra-Group Services

The OECD has introduced an elective, simplified approach for pricing low value-adding intra-group services. Inland Revenue has recognised that there are considerable benefits for taxpayers in aligning our practice with international standards and has adopted this simplification measure for qualifying low value-adding intra-group services with a total value below NZ\$1m per annum. For income years commencing on or after 1 July 2018, qualifying services may be priced at cost plus a mark-up of 5% without the need to provide benchmarking analysis.

## Application of Restricted Transfer Pricing Approach to Outbound Loans

New rules have been introduced requiring certain related-party loans between a non-resident lender and a New Zealand-resident borrower to be priced using a restricted transfer pricing approach. To further reduce compliance costs, Inland Revenue will accept a symmetrical approach also being taken on outbound loans. Accordingly, where New Zealand-resident lenders correctly apply the restricted transfer pricing approach to set the interest rate on their loans to related non-resident borrowers, we will consider the result to be arm's length. This is on the basis that the amount deducted by the non-resident borrower in the foreign jurisdiction does not exceed the amount returned as income by the New Zealand resident lender.

## Small Value Loans

For small value loans (i.e. for cross-border associated party loans by groups of companies for up to \$10m principal in total), we currently consider 325 basis points (3.25%) over the relevant base indicator is broadly indicative of an arm's length rate, in the absence of a readily available market rate for a debt instrument with similar terms and risk characteristics. Transactions priced in accordance with this simplification measure are likely to present a low transfer pricing risk and as such no further benchmarking is required.

## Small Wholesale Distributors

Foreign-owned wholesale distributors (i.e. firms that purchase and on-sell goods to other firms without significant transformation) are the most common multinational business model encountered in New Zealand.

For foreign-owned wholesale distributors with an annual turnover of under \$30m, we currently consider a weighted average EBITE ratio of 3% or greater is broadly indicative of an arm's length outcome in the absence of readily available transactional data for that distributor's transfer pricing transactions or other comparable market data for distributors operating with similar risk characteristics.

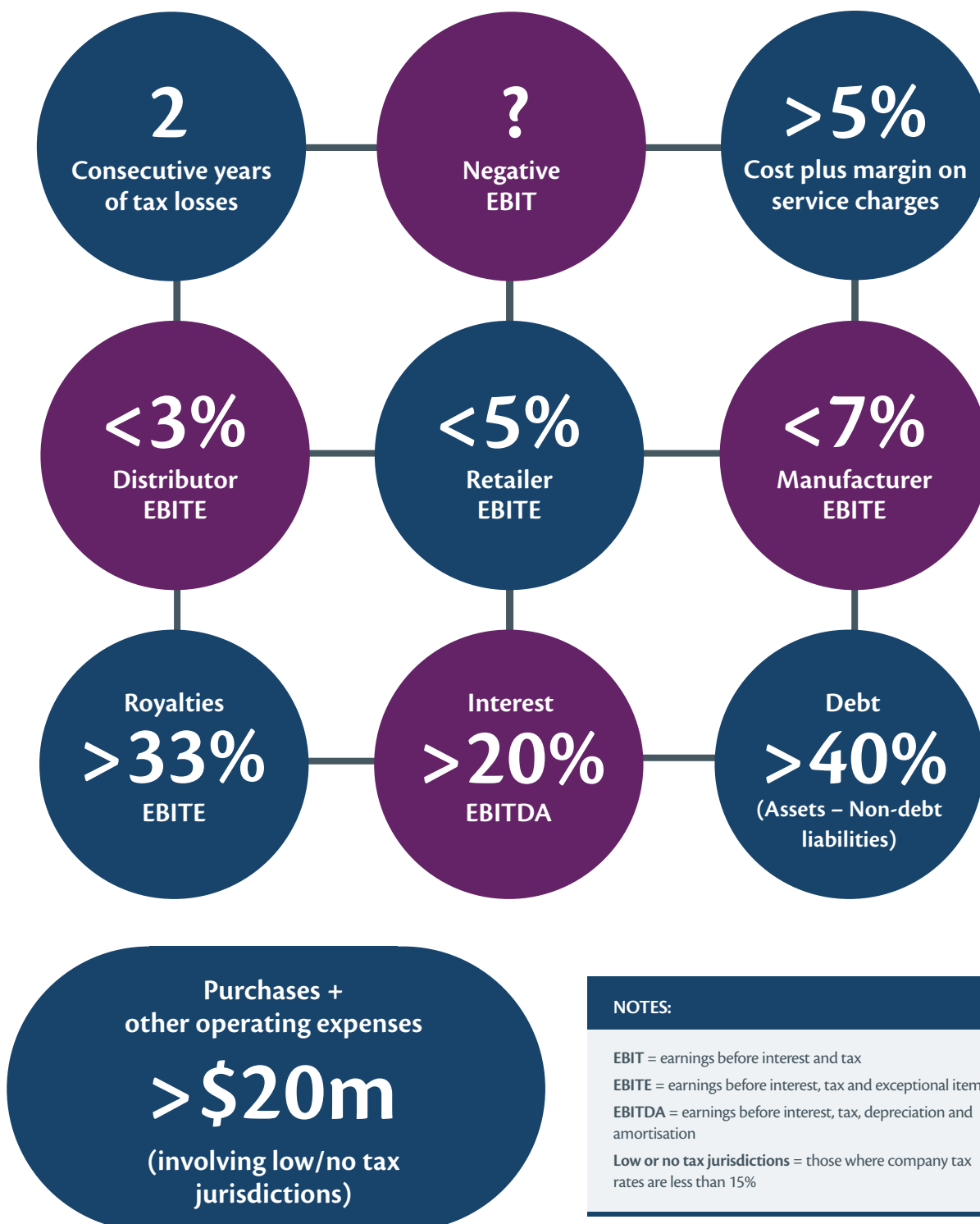
Transfer pricing outcomes in accordance with this indicative ratio are likely to present a low transfer pricing risk and as such no benchmarking is required to support the arm's length nature of the distributor's weighted average EBITE ratio.

## Further Measures

Inland Revenue is considering additional simplification measures, including threshold levels set for existing measures, especially in respect of coverage of small and medium enterprises. We continuously monitor best practices of other tax administrations and are open to ideas on potential measures from both tax practitioners and the business community.

# “You Do The Math”

Draw a high-level risk picture by using the following simple checklist. If any one (or more) of the risk indicators listed below is present then don't be surprised if we ask you for additional information.



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# New Permanent Establishment Anti-Avoidance Rule

New Zealand has adopted a new PE definition in our double tax treaties by signing and ratifying the MLI. However, this only applies if the other country signs the MLI and chooses to adopt the definition. Where the new definition does not apply, a new anti-avoidance rule has been passed into our domestic law which also overrides those double tax treaties without the widened MLI definition. These anti-avoidance measures target multinationals with global turnover above EUR 750m that try to avoid New Zealand tax by carrying on significant sales activities through associated or commercially dependent parties in New Zealand.

## **The following factors will be applied by Inland Revenue to determine whether more in-depth inquiries are required in this regard:**

- Significant functions are in practice carried out in New Zealand in relation to the sale, including those activities designed to convince a customer to acquire supplies from the non-resident.
- The non-resident has little or no contact with the New Zealand customer (other than executing the sales contract).
- The more complicated the supply, the more likely significant functions will be carried out in New Zealand to achieve sales.
- The employees of the New Zealand facilitator are highly remunerated, possibly indicating the provision of high value activities for non-residents.
- No or low foreign tax ultimately being payable on the income from New Zealand (though the payment of tax on the income in another jurisdiction is not sufficient to circumvent the application of the rule).

Where a supply is subject to the new rule, the non-resident is deemed to make that supply through the deemed PE. The activities of the facilitator in relation to the supply are also attributed to the PE. Notional charges for royalties and intra-company funding as well as mark-ups on general administration services will generally not be available as deductions for branch-to-branch and head office-to-branch dealings.

Inland Revenue is supportive of taxpayers in restructuring their New Zealand operations in response to this new PE anti-avoidance rule by either adopting a formal PE, or by moving to a standard local distributor model (where the goods or services are sold by the non-resident to an associated party that then on-sells the goods to unrelated customers). However, Inland Revenue will not accept returning more income in another taxpayer in lieu of a formal restructure.

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# Hybrid and Branch Mismatches

New Zealand has adopted new rules to counter hybrid and branch mismatches, following closely the BEPS Action 2 recommendations of the OECD. Hybrid and branch mismatch arrangements are cross-border arrangements that exploit differences in the tax treatment of an instrument, entity or branch under the laws of two or more countries to eliminate, defer or reduce income tax. This is often referred to as double non-taxation.

## Common examples of mismatches include the following:

- A payment that is interest and deductible in New Zealand, but is treated as an exempt dividend in another jurisdiction.
- A deductible payment made by a New Zealand subsidiary to its foreign parent where, under the tax law in the parent's country, the parent treats the subsidiary as a branch and disregards it.
- A dual resident company or branch that claims deductions for expenditure in both New Zealand and another jurisdiction.

## The following are not hybrid mismatches:

- Mismatches in tax rates between jurisdictions.
- Deductible payments made to tax exempt entities (unless they would be hybrid payments if made to a taxable entity).
- Deductible payments made to entities in a jurisdiction that does not tax foreign-sourced income.

With the exception of structured arrangements, the new rules are limited to taxpayers that are related to persons subject to tax in one or more other jurisdictions or are themselves subject to tax in another jurisdiction. Taxpayers who are potentially affected by the rules will need to ensure they understand how payments made to or by them are treated by their counterparty for tax purposes.

The intended outcome of the introduction of hybrid and branch mismatch rules is to reduce the incidence of hybrid and branch mismatch arrangements. Generally, if a taxpayer chooses an ordinary arrangement or structure over one that exploits a mismatch, then the tax advantage will be removed, without any need to apply the hybrid and branch mismatch rules. Even if this choice does not result in additional tax revenue for New Zealand, this is a desirable outcome.

*To monitor compliance with these new rules, the BEPS disclosure (to be completed with company tax returns) contains a section on hybrid and branch mismatches.*

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# Related-Party Financing Arrangements

Cross-border financings form a substantial part of total associated party dealings by New Zealand members of multinational groups. Key issues include the pricing of interest and guarantee fees at market rates, taking into account the special considerations addressed by the restricted transfer pricing rules, and capital structuring within New Zealand's thin capitalisation rules. New Zealand-owned multinationals also need to account for the very same issues in their outbound financing activities.

## Restricted Transfer Pricing Rules

New rules have been introduced requiring related-party loans between a non-resident lender and a New Zealand-resident borrower to be priced using a restricted transfer pricing approach. Under this approach, specific rules and parameters are applied to certain inbound related-party loans to:

- determine the credit rating of New Zealand borrowers at a high risk of BEPS; and
- remove any features not typically found in third party debt ("exotic features") in order to calculate (in combination with the credit rating rule) the appropriate amount of interest that is deductible on the debt.

For the purposes of the restricted transfer pricing rules, a New Zealand-resident borrower, who is neither an insuring nor lending person, will be considered a high BEPS risk when at least one of two factors is present:

- It has a New Zealand group debt percentage as measured for thin capitalisation purposes, that is greater than 40%, unless its ratio is within 110% of its world-wide group where relevant.
- The borrowing is from a low tax rate jurisdiction that is different from the ultimate parent (i.e. a borrowing from a lender resident in a country where the interest income is subject to a lower than 15% tax rate).

Exotic features under the new rules include:

- The term of the loan being greater than five years.
- Subordination.
- Payment other than in money (for example, repaying a loan by issuing shares).
- Interest payment deferral beyond 12 months.
- Options which give rise to premiums on interest rates (for example, on early repayment by the borrower).
- Promissory notes or other instruments which do not provide rights to foreclose/accelerate repayment in the event of borrower default.
- Contingencies (for example, where interest is repaid only under certain conditions).

Separate rules apply to financial institutions such as banks and insurance companies.

A lender may wish to invoke the mutual agreement procedure (MAP) if it considers that the deductible amount in New Zealand under the restricted transfer pricing rules is less than the lender's jurisdiction will require to be returned as income, applying the arm's length standard. This will require the presentation of a case to the lender jurisdiction's competent authority and/or the New Zealand competent authority. Borrowers are not entitled to determine their deductible interest on the basis that the restricted transfer pricing rules are over-ridden by a double tax agreement unless they have first been through the MAP process.





## Thin Capitalisation Rules

New Zealand's thin capitalisation rules have been based on the principle that a multinational group should not have significantly less capital in New Zealand, relative to the size of its New Zealand business, than it has on a worldwide basis, unless it has no more than a 60% debt/assets ratio. Historically, this comparison has been made by comparing the ratio of debt to assets for the New Zealand group with the same ratio for the worldwide group.

However, this measure did not deal well with companies which have non-debt liabilities (such as large trade creditors or deferred tax liabilities). When a New Zealand group has significant non-debt liabilities, its debt/assets ratio can appear relatively low, even though it has very little equity contributed by its owners. The thin capitalisation rules have been amended to prevent this, by excluding non-debt liabilities from the definition of assets.

A number of other changes have been made to strengthen the thin capitalisation rules, including:

- Reducing the ability for companies owned by a group of non-residents to use related-party debt.
- New rules for when a company can use an asset valuation for thin capitalisation purposes that is different from what is used for financial reporting purposes.
- An anti-avoidance rule that applies when a taxpayer substantially repays a loan just before the end of a year to circumvent the thin capitalisation rules.

*Note that the BEPS disclosure (to be completed with company tax returns) contains a section on both the restricted transfer pricing and thin capitalisation rules.*



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# Financing Risks Under Watch

## Cash Pooling Arrangements

Inland Revenue is monitoring cash pooling arrangements. In general, all cash pool participants should benefit from enhanced interest rates applicable to debit and credit positions within a cash pooling arrangement compared with the rates they would expect to obtain from borrowing or depositing cash outside the pool. If a negative balance in a cash pool extends beyond a short-term liquidity arrangement, it may be more appropriate to treat that participation as a term loan.

## Guarantees and Cross-Guarantees

The restricted transfer pricing rules do not explicitly refer to guarantee fees. Inland Revenue considers no fee is generally appropriate for a financial guarantee of debt between parties that are commonly owned unless it can be clearly shown that the guarantee provides benefits to the borrower beyond those that are obtained as a consequence of being part of a multinational group. In most circumstances, the guaranteed borrower will not

benefit beyond the level of credit enhancement attributable to the implicit support of other multinational group members.

Similar issues arise in respect of cross-guarantees, where two or more entities in a multinational group guarantee each other's obligations.

Payment of a guarantee fee to a non-resident related party may be appropriate if it guarantees third party debt. However, this would have to be considered on a case-by-case basis and the total cost of the arrangement would not be expected to materially exceed the cost of a non-resident group member borrowing from a third party and on-lending to the New Zealand borrower with the New Zealand borrower's interest deduction calculated under the restricted transfer pricing rules.

## Derivatives

We are monitoring the use of cross-border derivatives between related parties. Such derivatives should not only be priced in accordance with the arm's length principle but also must be commercially explicable.

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# Non-Resident Withholding Tax/Approved Issuer Levy

## Revised Rules

In 2017, a number of changes to the taxation of interest payments to non-residents were enacted to correct anomalies in the rules.

There were two parts to this reform package:

- (a) Changes to the NRWT rules generally to bring the rules dealing with timing and quantification of income subject to withholding tax in line with the financial arrangements rules, ensuring a better matching of deductions for the borrower with the imposition of NRWT on the lender.
- (b) Changes to the NRWT/AIL rules, which particularly affect branch structures previously used to get around the rules.

In relation to the first set of rules, New Zealand borrowers who have related-party debt where interest payments are made more than a year in arrears will need to consider whether the rules now require them to deduct NRWT on an accrual basis (i.e. as interest is deducted) rather than as payments are made.

# The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

The purpose of this multilateral instrument is to amend a significant number of bilateral double tax treaties to include recommendations from the BEPS Action Plan. The treaty allows New Zealand to update and strengthen most of our tax treaties without having to enter into negotiations with each of our tax treaty partners.

The MLI includes provisions to:	Corresponding BEPS Action
Tie-break dual resident entities	Action 2
Prevent the granting of treaty benefits in inappropriate circumstances (anti-treaty shopping)	Action 6
Prevent the artificial avoidance of permanent establishment status	Action 7
Provide improved mechanisms for effective dispute resolution	Action 14

Some jurisdictions have chosen to adopt the minimum standard provisions; others have adopted a combination of minimum standard and best practice provisions. New Zealand has agreed to adopt as many of the provisions as possible, as far as they are in line with our overall tax treaty policy. This is intended to give New Zealand the best chance of strengthening our treaties with as many jurisdictions as possible.

Treaty partner	Applies for withholding taxes from	Other taxes, for income years beginning on or after
Australia	1 January 2019	1 April 2019
France	1 January 2019	1 April 2019
Japan	1 January 2019	1 April 2019
Poland	1 January 2019	1 April 2019
Sweden	1 January 2019	1 April 2019
United Kingdom	1 January 2019	1 April 2019
Belgium	1 January 2020	1 April 2020
Finland	1 January 2020	1 April 2020
India	1 January 2020	1 April 2020
Ireland	1 January 2020	1 April 2020
Netherlands	1 January 2020	1 April 2020
Singapore	1 January 2020	1 April 2020
United Arab Emirates	1 January 2020	1 April 2020

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# The Digital Economy — “Unfinished Business”

There is ongoing concern with the taxation of the digital economy both in New Zealand and globally. It is possible under current rules for companies to derive substantial income from a country in which they have significant presence without being liable for income tax there. The OECD is trying to achieve an internationally agreed solution to the problem by the end of 2020, which would involve changing the current international income tax framework. Some countries have adopted separate digital services taxes as unilateral measures to address the problem in the interim.

New Zealand is actively participating in the OECD discussions on this major issue. An internationally agreed solution is considered preferable; however, we are considering other options such as a digital services tax should an international solution not be reached in a reasonable time frame. As a small open economy, we generally try to keep our tax policy settings within the bounds of international norms to provide a stable and certain environment for cross-border investment.

## June 2019 – Endorsement by G20

**“We welcome the recent progress on addressing the tax challenges arising from digitalization and endorse the ambitious work program that consists of a two-pillar approach, developed by the Inclusive Framework on BEPS. We will redouble our efforts for a consensus-based solution with a final report by 2020.”**

**The OECD proposals for addressing the tax challenges arising from the digital economy have been grouped into two pillars:**

### Pillar 1 – Nexus and profit allocation

Four proposals:

- (a) User contribution.
- (b) Marketing intangibles.
- (c) Significant economic presence.
- (d) Distribution approach.

All four proposals eliminate the physical presence requirement but determine profits in the source jurisdiction differently.

A “unified approach” based on the commonalities of all the above proposals is also to be considered.

### Pillar 2 – GloBE (Global anti-Base Erosion)

One proposal:

Address ongoing profit shifting that arises due to significant disparities in tax rates and limit the “race to the bottom” on tax rates. Provide residence and source countries a right to “tax back” profits subject to no or very low rates of taxation in jurisdictions where those profits are derived.

# Post-BEPS Top 10 Recommended Actions

<p><b>1</b></p> <p>Recalculate thin cap ratios (e.g. adjust for large trade creditors and deferred tax liability).</p>	<p><b>2</b></p> <p>Check borrower credit ratings, especially if less than investment grade (BBB-).</p>	<p><b>3</b></p> <p>Review loan agreements for exotic features (e.g. subordination, five year+ terms).</p>
<p><b>4</b></p> <p>Scrutinise inter-company contracts as to consistency with actual behaviour.</p>	<p><b>5</b></p> <p>Update transfer pricing documentation for control and management of key risks.</p>	<p><b>6</b></p> <p>Examine booking locations of all sales to New Zealand customers, especially where there is a New Zealand entity carrying out sales-related activity.</p>
<p><b>7</b></p> <p>Obtain reliable information about the foreign tax treatment of payments to foreign related parties and group members.</p>	<p><b>8</b></p> <p>Review treatment of foreign hybrid entities (e.g. Australian limited partnerships).</p>	<p><b>9</b></p> <p>Evaluate New Zealand branches and hybrid entities (e.g. limited partnerships and unlimited liability companies) as to possible double deductions.</p>
	<p><b>10</b></p> <p>Consider overall reasonableness of results – do they make sense as to New Zealand value add?</p>	

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# International Transparency

**“Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.” - Louis Brandeis (1914)**

The availability of timely, targeted and comprehensive information is essential to enable tax administrations to quickly identify risk areas. There has been a major paradigm shift globally over the last ten years to greater disclosure and increased international exchanges of information.

## **Multilateral Convention on Mutual Administrative Assistance in Tax Matters**

This convention is the most comprehensive multilateral instrument available for all forms of international tax co-operation. New Zealand has signed and ratified the convention and, with 130 jurisdictions currently participating in the convention, our exchange of information network now extends to all G20 countries, all BRICS, all OECD countries and major finance centres.

## **Exchange of Information on Tax Rulings**

In accordance with the BEPS Action 5 minimum standard, New Zealand exchanges information on tax rulings, primarily summary details of unilateral advance pricing agreements and permanent establishment determinations. In the three years to 31 December 2018, New Zealand has exchanged details on 106 qualifying rulings and received details from treaty partners as to 164 qualifying rulings.

The initiative has been aimed at “soft” or “sweetheart” rulings that may in effect provide tax holidays to multinationals. Not only has the receipt of details of rulings from treaty partners provided valuable insights into arrangements of

multinationals, the initiative has provided much needed integrity to the overall system of rulings internationally.

## **Country-by-Country Reporting**

New Zealand exchanges CbC reports with treaty partners in accordance with the BEPS Action 13 minimum standard. In the first year of the initiative, New Zealand exchanged CbC reports for 21 multinationals headquartered here and, in the year to 31 December 2018 we received 1402 CbC reports from treaty partners. Over two-thirds of foreign-owned multinationals with annual group turnover in New Zealand above \$30m are subject to inward-bound CbC reporting.

The rich information in these CbC reports as to how multinationals allocate their global income together with indicators as to the location of economic activity within these groups, further strengthen our transfer pricing risk assessments, providing us with a full picture of supply chain profitability.

## **Joint International Taskforce on Shared Intelligence and Collaboration**

Inland Revenue, along with 39 other tax administrations, is an active member of JITSIC which offers a platform to enable active collaboration within the legal framework of bilateral and multilateral conventions and tax information exchange agreements. New Zealand has benefited through the sharing of intelligence and strategies to deal with emerging tax risks involving multinationals as well as advances in analytical techniques and best practice compliance approaches.

## **Liaison with New Zealand Customs Service**

Customs plays an important role in New Zealand's international trade. Customs and Inland Revenue work closely together, especially in respect of period-end valuation adjustments. It is not uncommon for multinationals to invoice their intercompany transactions based on budget data and then adjust at year end to earn an agreed arm's length operating margin.

The new provisional values scheme in the Customs and Excise Act 2018 allows certain importers to provide a reasonable estimate of value on an import entry when they cannot establish the customs value at time of import. Importers with acceptable transfer-pricing arrangements can apply to use provisional values. Customs now consults with Inland Revenue to determine whether the importer does have an acceptable transfer-pricing arrangement where the criteria for automatic qualification for the provisional values scheme are not met.

## **Contributing to Capacity Building in Asia and the Pacific**

Greater tax transparency and the exchange of information are vital to combatting aggressive tax planning. New Zealand is committed to supporting tax administrations in Asia and the Pacific in implementing international tax standards and increasing international co-operation. We do this by way of various one-to-many outreach activities and participation in joint training events arranged through organisations such as the OECD (Global Relations), the Study Group on Asian Taxation Administration and Research, and the Pacific Islands Tax Administrators Association.

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# Binding Rulings, Factual Reviews, Indicative Views and Advance Pricing Agreements

To provide taxpayers with greater assurance about tax issues and to get it right from the start we have a range of options in place.

## Binding Rulings

We can issue binding rulings for taxpayers to provide certainty about the interpretation of tax laws.

A binding ruling is Inland Revenue's interpretation of how a tax law applies to a particular arrangement or to the tax status of a person or thing. An arrangement is any agreement, contract, plan or understanding (whether or not it is enforceable), including any steps and transactions that carry it into effect. In addition, we have the ability to rule on the status of a taxpayer, such as whether they are a "non-resident", and certain other matters, without the need to have an arrangement.

From 1 October 2019, we are providing short process rulings. The basic criteria for being eligible to apply for this type of ruling are the person's annual gross income for the tax year prior to the year in which the application is made is \$20m or less and the matter on which the ruling is sought concerns a tax (other than provisional tax), duty, or levy that is expected to amount to less than \$1m.

If you have been given a binding ruling, you are not required to follow the ruling. But if you do follow a binding ruling exactly as described in the ruling and satisfy any stated conditions, Inland Revenue is bound by it. A binding ruling does not remove the requirement to file

an income tax return and pay any taxes arising either by following the ruling, or taking a different tax position.

Before you apply for a binding ruling, you can set up a pre-lodgement meeting to help clarify the issues and determine the scope of the ruling. We aim to complete binding rulings within 10 weeks of an application, although shorter timeframes may be possible in some circumstances. For more information, please refer to our guide for Binding Rulings (IR715).

## Factual Reviews

If you have applied for a binding ruling, you may request a factual review to obtain a level of certainty on whether a critical factual condition in the ruling will be satisfied. You can request a factual review (in writing) at any time before or immediately after the issue of the ruling.

## Indicative Views

In some circumstances, a request for an indicative view may be a more suitable option.

Indicative views are not binding on the Commissioner and are available to larger enterprises. An indicative view would generally be provided for prospective major transactions. It will not be provided for arrangements involving potential tax avoidance or hypothetical situations.

## Advance Pricing Agreements

Advance pricing agreements have proven extremely useful as a robust upfront means of dealing with transfer pricing risk, especially the more complex issues that arise.

An APA is an agreement between Inland Revenue and the taxpayer which confirms the basis for their international pricing. Multinationals that complete an APA need to submit annual reports and supporting evidence to us to confirm their compliance with the agreement.

APAs represent a more co-operative approach to tax compliance as opposed to potentially adversarial audits. The product is ideally suited to the more complex transfer pricing issues such as intangibles and the provision of specialised services. We completed 23 APAs this last year, 11 more than 2018. As at 30 June 2019, we had completed 205 APAs in total.

Most of our bilateral APA work has been with Australia. We have also completed bilateral APAs with Belgium, Canada, Japan, Korea, Switzerland and the United States. We are currently working on our first bilateral APAs with China, India and the United Kingdom.

We have found unilateral APAs successful in both inbound and outbound transfer pricing scenarios. Although unilateral APAs are one-sided, should double taxation arise on transactions covered by a unilateral APA, we will enter into competent authority negotiations with the other jurisdiction on the basis of the unilateral APA position. Unilateral APAs are especially viable where the amounts at stake are small and/or where most of the transfer pricing risk lies in New Zealand. Our aim is to complete unilateral APAs within six months of the date of acceptance of a formal application. Bilateral negotiations, especially beyond Australia, generally take considerably longer to conclude.

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# International Disputes



## Mutual Agreement Procedure

New Zealand has 40 double taxation agreements, each with an article establishing a mutual agreement procedure for resolving difficulties arising out of the application of the particular DTA. New Zealand has 11 tax information exchange agreements (TIEAs) in force which also contain a MAP article, as well as six supplementary agreements to these TIEAs which include a MAP article.

Under the MAP article, the competent authorities of the contracting states engage with each other and endeavour to resolve disputes that arise from the way one or both contracting states are interpreting or applying the particular DTA. Article 25 effectively equips the tax administrations with the practical means to ensure that cross-border income earning activity is taxed correctly in accordance with DTAs.

Our overall aim is to complete MAP cases within 12 months of receiving a request for assistance. The time taken to resolve MAP cases will vary depending largely on the complexity of the matter in dispute. We have experienced a moderate case load in recent years with good turnaround times as follows:

Year to 31 December	Number Resolved	Average Cycle Time (months)
2015	18	10
2016	6	18
2017	19	10
2018	10	7

The genesis of BEPS Action 14 developed from a recognition that the actions to counter BEPS must be complemented with actions that ensure certainty and predictability for businesses and individuals. It was therefore necessary to develop robust dispute settlement processes across jurisdictions to ensure that disputes are resolved in a timely, effective and efficient manner.

New Zealand is a member of the Forum on Tax Administration's MAP Forum and has committed to resolving treaty-related disputes within an average timeframe of 24 months. We have also been subject to a rigorous peer review by the MAP Forum, their main recommendation being that we update a number of our older DTAs to the latest wording of the OECD Model Tax Convention, which we are progressing through the implementation of the multilateral instrument and bilateral negotiations.

## Arbitration

New Zealand has opted to apply Part VI of the MLI which introduces arbitration as a means of dispute resolution. If a solution cannot be reached under MAP, taxpayers have the ability to request unresolved issues be taken to arbitration. New Zealand has had arbitration in the double tax treaties with Australia and Japan but has had no requests to date. We consider arbitration incentivises competent authorities to resolve disputes within a reasonable time period (the general standard being two years).



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# Tax Treaty Programme Update

New Zealand continues to work with the OECD and treaty partners to ensure our international agreements are fit for purpose. We have double tax agreements with 40 countries and negotiate updates to those DTAs and conclude new DTAs as needs or circumstances arise. The most recent notable update has been a new DTA signed with China on 1 April 2019 (this is not yet in force).

We commenced the automatic exchange of financial account information with the United States in September 2015 and, following New Zealand's commitment to the OECD's Common Reporting Standard, we have agreed to exchange financial account information to another 90 jurisdictions.

We have a number of on-going international commitments, including:

- Active participation in various OECD and Forum on Tax Administration working parties and projects, membership of the Study Group on Asian Tax Administration and Research, and observership with the Belt and Road Initiative Tax Administration Cooperation Forum; and
- Supporting the Ministry of Foreign Affairs and Trade free trade agreement programme and the New Zealand delegation at the United Nations on tax matters.

## Tax Treaty Abuse

BEPS Action 6 identified tax treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concerns. Taxpayers that engage in treaty shopping and other types of treaty abuse undermine tax sovereignty by claiming treaty benefits in inappropriate circumstances, especially where companies route profits through low or no tax jurisdictions to avoid paying taxes in a third country.

Tackling treaty shopping is one of the four BEPS minimum standards, and jurisdictions have committed to include provisions in their tax agreements to ensure a minimum level of protection against treaty shopping. The majority of Inclusive Framework members, including New Zealand, are progressing towards implementation of the minimum standard by modifying their treaty networks with the help of the multilateral instrument.

## Dual Resident Entities - Good Housekeeping Required

Dual resident entities can be used to take advantage of arbitrage opportunities by manipulating the current "place of effective management" test in double tax treaties. Article 4(1) of the MLI, if countries agree to its application, requires competent authorities to determine the residence status of a dual resident entity. If there is no agreement, then treaty benefits will be denied or only granted to the extent to which the competent authorities can agree.

In making a determination, competent authorities will consider several factors:

- Place of effective management;
- Place where the company is incorporated or otherwise constituted; and
- Any other relevant factors.

In terms of trade and investment, our double tax treaty with Australia is the most significant and this has been modified accordingly as to dual residence by the MLI with effect from 1 January 2019. Taking a risk-based approach, the two competent authorities have agreed an administrative practice which should result in the great majority of trans-Tasman corporates being excluded from the competent authority determination process. From a practical perspective, the tax consequences of being a dual resident company can lead to a number of undesirable outcomes (restrictions on maintaining an imputation credit account, grouping losses, being a member of a consolidated tax group and deductions being denied under anti-hybrid rules). New Zealand companies doing trans-Tasman business need to carefully review their governance arrangements (including where board meetings are held and where directors and senior executives make strategic decisions) to ensure dual residence does not arise inadvertently.

# Business Transformation

To deliver on our objectives and vision for a modern tax system, we have embarked on a major change programme. Our multi-year, multi-stage Business Transformation programme is reshaping the way the department serves New Zealanders. Simple, certain and open customer-centred services are being designed and delivered in partnership with others inside and outside government.

The overall result will be a modern, digital tax system that will serve the needs of all New Zealanders and fit seamlessly into their lives. It will also be a system that keeps pace with change, protecting the Government's ability to keep providing services. Delivering our future tax system will require us to:

- Simplify policy and legislative settings.
- Make more intelligent use of information to ensure customers get it right from the start.
- Fit revenue processes seamlessly into people's lives and enable them to self-manage with speed and certainty.
- Become more agile, effective and efficient.
- Implement a modern technology platform that is digitally based and highly automated.

## This year saw the most significant changes to tax on income in a generation including:

- Migrating income tax and Working for Families to new systems and processes.
- Introducing a new, automatic year-end process so that people who only earn income which is reported to Inland Revenue no longer need to do anything at the end of the year.
- New reporting requirements for employment and investment income information.
- Implementing and operating a data and intelligence platform to enable better tailoring and targeting of services to customers.
- Replacing Inland Revenue's website and revamping digital channels and services.
- Implementing and embedding new tool sets and equipment that support Inland Revenue's new ways of working, including networked teams and more remote working.
- Implementing a new Enterprise Support Services platform which will replace Inland Revenue's existing human resources and financial systems.

## New analytical capabilities are changing the way Inland Revenue interacts with customers

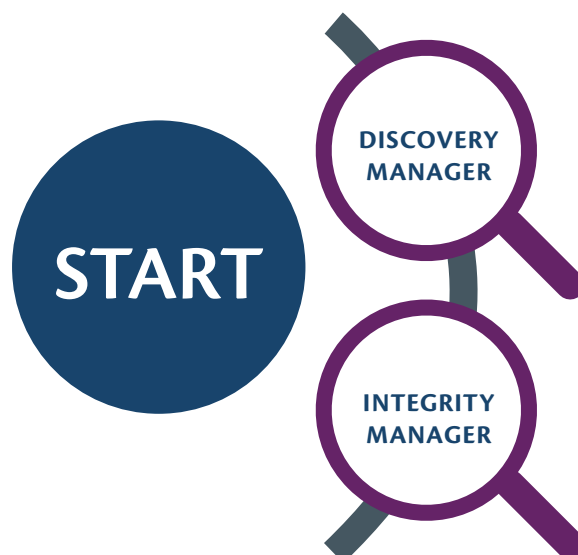
Discovery Manager and Integrity Manager are capabilities within START. Discovery Manager is where Inland Revenue looks at returns received and information held to "discover" things. For example:

- Customers registering for GST are separated into different groups, such as those registering for the first time, and tailored education is provided to them.
- Employer information files are analysed to identify inaccurate information early.
- People on incorrect tax codes can be helped to get things right, for example, by suggesting a tailored tax code to them.

Integrity Manager enables assessments and refunds to be stopped where there is a high likelihood they are wrong or fraudulent. Inland Revenue may call the customer, release the return or refund, or decide to investigate further. Things that require review are now more easily identified. For example:

- Rules look at donations as a percentage of income.
- Claims for non-business expenses can be assessed.
- Searches can be done for IP addresses and the use of anonymisers or proxies.

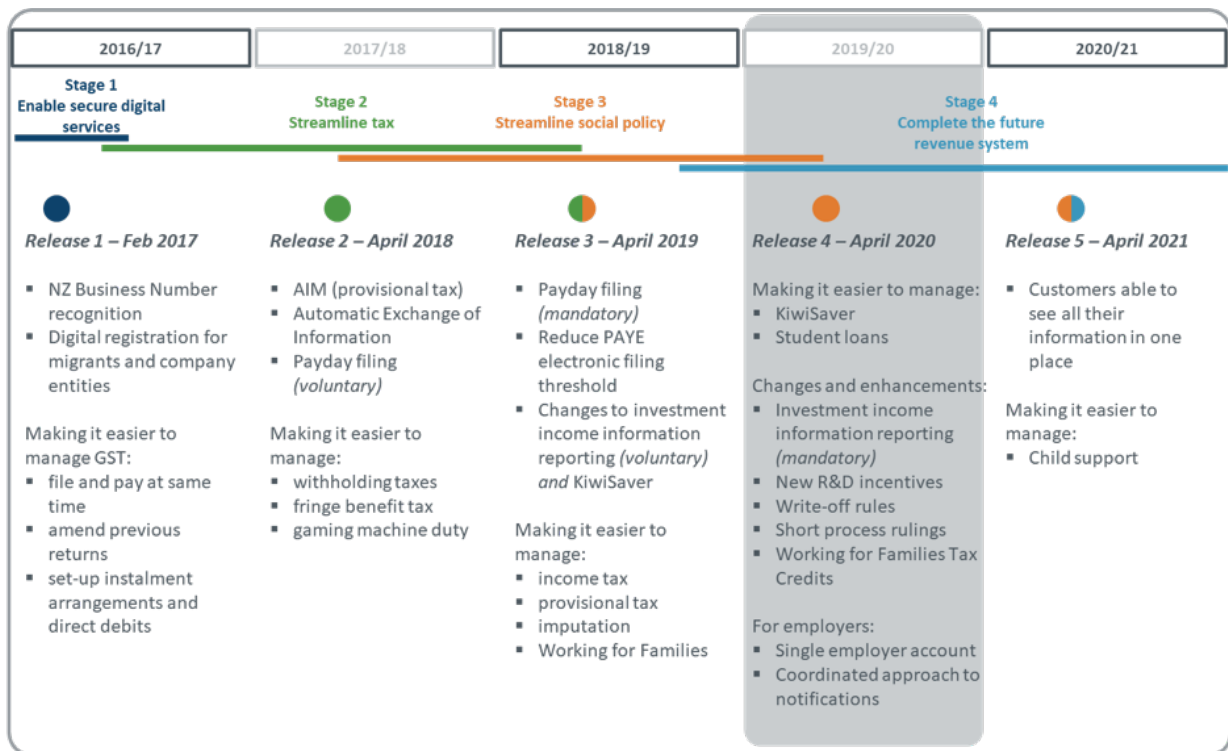
Inland Revenue also has the ability to view someone's session online if there is doubt – such as a customer making multiple changes and then checking back repeatedly to see the progress of a refund.



Third parties and customers will be proactively contacted during the year where Inland Revenue identifies things that are not right:

- Deductions and entitlements will be adjusted during the year as customers' circumstances change to ensure assistance is provided at the time it is needed and tax is withheld correctly.
- There will be fewer errors because problems will be identified during the year and customers prompted to address them, making any under or over payments easier to manage.
- More people will be on the right tax code regardless of their employment arrangements.

Over time, proactively prompting customers to make changes during the year will mean fewer people will end up with a refund or tax to pay at the end of the year. In addition, the average amounts will be less. It will take a couple of cycles for these benefits to become fully evident.



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# Glossary

<b>AIL</b> Approved issuer levy	<b>APA</b> Advance pricing agreement	<b>BCP</b> Basic compliance package
<b>BEPS</b> Base erosion and profit shifting	<b>BRICS</b> Brazil, Russia, India, China and South Africa	<b>CbC</b> Country-by-country reporting
<b>DTAs</b> Double taxation agreements	<b>EBIT</b> Earnings before interest and tax	<b>EBITDA</b> Earnings before interest, tax, depreciation and amortisation
<b>EBITE</b> Earnings before interest, tax and exceptional items	<b>Guidelines</b> OECD Guidelines for Multinational Enterprises	<b>IMF</b> International monitoring framework

<p><b>IQ</b></p> <p>International questionnaire</p>	<p><b>JITSIC</b></p> <p>Joint International Taskforce on Shared Intelligence and Collaboration</p>	<p><b>MAP</b></p> <p>Mutual agreement procedure</p>
<p><b>MLI or multilateral instrument</b></p> <p>Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS</p>	<p><b>MNEs</b></p> <p>Multinational enterprises</p>	<p><b>NRWT</b></p> <p>Non-resident withholding tax</p>
<p><b>OECD</b></p> <p>Organisation for Economic Cooperation and Development</p>	<p><b>PE</b></p> <p>Permanent establishment</p>	<p><b>PPT</b></p> <p>Principal purpose test</p>
<p><b>SE</b></p> <p>Significant enterprises</p>	<p><b>TIEA</b></p> <p>Tax information exchange agreement</p>	<p><b>UN</b></p> <p>United Nations</p>

# Contacts

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