

1 May 2017

Policy and Strategy  
Inland Revenue  
PO Box 2198  
Wellington

By email: [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

## **Base Erosion and Profit-Shifting (BEPS) – Transfer Pricing and Permanent Establishment Avoidance**

### **Introduction and general comments**

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on *BEPS – Transfer Pricing and Permanent Establishment Avoidance: A Government discussion document* (discussion document).
2. The Law Society is concerned about the proposed approach to amending the effect of New Zealand's existing international treaties. We acknowledge that other countries have enacted similar rules to those proposed. Nevertheless, we consider that there is limited scope for New Zealand to enact changes in the name of 'avoidance rules' which have the effect of overruling the clear wording in our international treaties.
3. Under our treaties, foreign companies resident in countries with tax treaties that do not carry on business from a permanent establishment are afforded protection against New Zealand tax on their income from New Zealand. In return, that foreign country affords New Zealand companies the same protection.
4. It is generally accepted that the protections provided in the treaty must be subject to general rules that prevent their abuse. However, there is a line between such general rules and more specific provisions that are intended to simply undo the negotiated position reflected in the treaty. Legislation enacting this latter category is not appropriate.
5. On its own, a specific anti-avoidance rule of the type proposed may not contravene our treaty network, however the position is less clear when the entire package of proposed amendments is considered. Under the proposals, not only will foreign companies now be exposed to tax when, on the plain wording of the treaty this should not be the case, but it is also proposed that they will be subject to a different regime for the investigation and challenge of their taxes.
6. The Law Society submits that this is not in accordance with the spirit of our treaty network. It is also arguably not in accordance with the legal effect of our existing treaty network; particularly when one considers that the proposed multi-lateral instrument provides a mechanism for countries to amend their treaties to give effect to the substance of these changes.

7. Where countries choose not to amend their treaty, New Zealand should not be able to impose this change on them through our domestic rules.

### **Chapter 3: Permanent Establishment (PE) avoidance**

8. Chapter 3 proposes to adopt a rule very similar to the ones found in the UK Diverted Profits Tax (UK DPT) and the Australian multinational anti-avoidance law (MAAL). The rules would purport to deem a permanent establishment (PE) to exist where one exists in substance despite what is documented under legal arrangements.
9. At a conceptual level, a move to a substance based test would not necessarily result in a different outcome than that arising under an appropriate application of the transfer pricing rules. New Zealand tax payable under a deemed PE should in essence be materially the same as that payable by the relevant New Zealand entity earning an appropriate margin determined under the transfer pricing rules. On this basis, the Law Society submits that there should be no need for a specific PE avoidance rule, in addition to an introduction of more robust transfer pricing rules.
10. If, nevertheless, this rule is implemented then it will be important to ensure that it is drafted so that taxpayers have a high level of certainty as to how it applies to their affairs. This is particularly important as the effect of this rule will directly impact on how easy it is to do business with New Zealand, as a foreign multi-national; and a poorly implemented rule will see New Zealand worse off.
11. The Law Society recommends that any legislation should include a provision similar in effect to section CD 22(8), which would allow taxpayers to seek specific confirmation from Inland Revenue that the PE avoidance rules do not apply to their structure. We expect a number of multi-nationals could seek to use this mechanism to give themselves certainty as to how New Zealand will tax their arrangements. We do not consider that the binding rulings regime would give the same level of comfort, given that the proposed legislation is an anti-avoidance rule.

### **Chapter 5: Strengthening the transfer pricing rules**

#### *Extension of time bar from four to seven years*

12. The Government proposes to increase New Zealand's time bar for transfer pricing matters from four years to seven years.
13. The discussion document states in paragraph 5.69 that it can be difficult for tax authorities to adequately identify the risk, apply the arm's length principle and amend the relevant tax return within four years. However, the Law Society submits that the need to extend the time bar period should be much less relevant if the burden of proof shifts to taxpayers as proposed in paragraphs 5.43 to 5.48 of the discussion document.
14. The Government will already have access to improved information flows through:
  - master file and local file transfer pricing documentation under OECD recommendations; and
  - automatic exchanges of information between Revenue Authorities.
15. The Law Society is not convinced that it is necessary to have a bespoke limitation period for transfer pricing, particularly given the proposal to move the burden of proof to the taxpayer.

16. Further, although paragraph 5.71 specifically refers to the Government's proposal being limited to increasing New Zealand's time bar for transfer pricing matters to seven years, there are complications associated with an adjustment for transfer pricing interacting with other types such as income tax, withholding tax, etc. The Government should therefore ensure that any flow-on effect to other tax types arising from transfer pricing adjustments is carefully managed in drafting proposed legislation.

#### *Shift of burden of proof to taxpayers*

17. The Law Society submits that a longer transitional period is appropriate for any change to the burden of proof. The current proposal for the burden to shift from the first income year after enactment does not provide sufficient time for taxpayers to review their documentation in light of the changed rules.

### **Chapter 6: Administrative measures**

#### *Non-cooperation*

18. It is proposed in Chapter 6 that non-cooperation from large multinationals could result in the proposed new administrative measures being applied (e.g. Inland Revenue issuing an assessment based on information held at the time, the imposition of fines of up to \$100k for failure to comply with information requests, etc.) in order to prevent a subsidiary's non-compliance from frustrating Inland Revenue's transfer pricing investigation.
19. The Law Society submits that the factors that lead to a finding that a taxpayer is "non-cooperative" are too wide. For example, one of the factors put forward in the proposal in paragraph 6.16 of the discussion document includes "failure to respond to Inland Revenue correspondence".
20. Information required by Revenue Authorities from large organisations can be onerous and take considerable time to obtain. In practice, the Law Society also expects that where large amounts of information are requested, taxpayers will often obtain and provide information to a standard akin to that of legal discovery to avoid repetition should the investigation progress to litigation. Feedback received by the Law Society indicates it is frequently difficult to obtain the level of material required by Inland Revenue within the timeframes set, owing to an apparent lack of appreciation by Inland Revenue of the practical realities of sourcing the information requested.
21. The Law Society considers that the difficulty described above would not be unique to large multinationals and expects that delays in obtaining information are generally not driven by an unwillingness to provide information, but rather result from the timeframes required to obtain information from within large organisations.
22. The Law Society does not consider that there is sufficient basis for a standalone rule applying to transfer pricing disputes, and that the existing rules provide adequate protection for Inland Revenue.

#### *Collection of information*

23. It is proposed in paragraph 6.33 of the discussion document that the Commissioner be provided with a direct power to request information or documents that are held by or accessible to a group member that is located outside New Zealand.

24. The Law Society considers that Inland Revenue has sufficient ability to collect information from large multinationals under existing rules by virtue of country-by-country (CBC) reporting and automatic exchange of information with other Revenue Authorities. In practice, the Law Society expects that delays in obtaining information are generally a result of New Zealand being a smaller jurisdiction relative to the rest of the world. This can result in a lack of resource within multinational organisations being available to prioritise information requests relating to New Zealand.
25. The Law Society therefore considers that the introduction of specific provisions enabling Inland Revenue to directly request information or documents offshore would be unlikely to result in Inland Revenue receiving information in a timelier manner. As mentioned above, the Law Society anticipates that delays tend to be attributable to the difficulty within large organisations to obtain information requested (particularly in light of the size of New Zealand relative to other jurisdictions that multinationals operate in), rather than as a result of unwillingness by large multinationals to provide information.
26. The Law Society therefore submits that officials reconsider the proposal to increase the Commissioner's ability to collect information from multinationals, given that:
  - it is unlikely that this proposal would increase Inland Revenue's ability to collect information in a more timely manner; and
  - the introduction of CBC reporting rules and automatic exchanges of information.

#### *Penalties for not providing information*

27. Paragraph 6.35 of the discussion document proposes that a person may be convicted of an offence for failing to provide information held by an associated offshore group member. This would presumably apply to officers of a New Zealand subsidiary.
28. As discussed above in the context of new administrative measures for non-cooperation and wider information collection powers, New Zealand tends to be a small subsidiary in the context of large multinationals' operations. Officers and/or directors of New Zealand subsidiaries will often have little or no ability to compel offshore parent companies to provide information. The Law Society therefore considers that it would not be appropriate to impose penalties on New Zealand officers.

#### *Requirement to pay disputed taxes early*

29. It is proposed in paragraph 6.22 of the discussion document that for large multinationals engaged in particular kinds of disputes, the time at which the tax must be paid should be brought forward. The proposal is said to intend to remove any incentive for a taxpayer to prolong a dispute with Inland Revenue.
30. The reason provided in paragraph 6.21 is not compelling, given that use of money interest (UOMI) would run from the time when the tax should have been paid and penalties would apply to late payments, as it does for any other dispute. The Law Society expects that taxpayers generally do not enter into a dispute with Inland Revenue to delay the payment of tax. Instead, it is likely to be because there is a genuine dispute over the amount of tax payable.
31. It is difficult to see the justification for large multinationals in dispute with Inland Revenue to be treated differently from any other New Zealand taxpayer in this respect. The Law Society

considers the UOMI regime to be a strong enough disincentive not to prolong a dispute and is further evidenced by taxpayers using tax pooling services to mitigate UOMI.

32. We also note that section 138I of the Tax Administration Act (TAA) previously required taxpayers to pay 50% of the amount of tax being disputed, which applied for all tax disputes. This requirement was removed on 1 April 2003 as the Government felt that UOMI provided the incentive to ensure that taxpayers do not dispute an amount payable merely to delay payment. To balance the removal of the requirement to pay 50% of the disputed tax, Inland Revenue was given the power under section 138I(2B) to require payment of all the tax in dispute in those rare cases where there is a significant risk that the amount in dispute might never be paid. The Law Society considers that this power (as it was then) should remain effective where there is a real concern from Inland Revenue in respect of their ability to collect tax.
33. The discussion document also proposes in paragraph 6.24 that purchases from a tax pooling service would not be accepted as the payment of tax for the purpose of satisfying payments of disputed taxes. No justification was provided in the discussion document and it is difficult to see any justification for this limitation.
34. Based on the above, the Law Society submits that:
  - there should be no need to require multinationals to pay disputed tax earlier than any other taxpayer in New Zealand; and
  - the ability to use tax pooling services should continue to be available to multinationals as it is for other taxpayers in New Zealand.

#### *Economic substance approach to transfer pricing*

35. As stated in paragraph 5.2 of the discussion document, the proposed new rules would disregard legal form if it does not align with the actual economic substance of the transaction. It is foreseeable that Inland Revenue and taxpayers will continue to have different views on the relevant entities' economic substance. As such, the Law Society expects that a move to an economic substance approach is still likely to ultimately lead to dispute that would not necessarily be any different to disputes under the current legal form approach.

#### **Application dates**

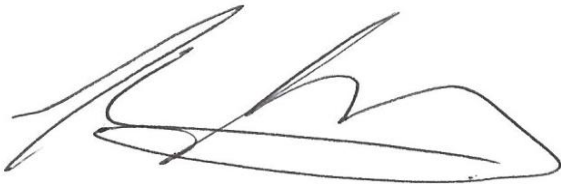
36. The discussion document states that the proposed administrative rules would apply from the date of enactment of the legislation and the proposed rules for addressing the source, PE and transfer pricing issues would apply to income years beginning on or after the date of enactment. There was no comment in the discussion paper about transitional or grandfathering rules for existing structures.
37. The Law Society understands from paragraph 3.39 of the discussion document that the ultimate objective of the proposed PE avoidance rule is to discourage non-residents from entering into PE avoidance structures in the first place. However, if the proposed changes are genuinely intended to be a disincentive, officials would presumably expect a number of restructures to occur as a result of the proposed changes. Restructures, particularly in the context of large multinationals, generally take a reasonable amount of time and resources to implement.

38. The Law Society therefore submits that provisions for transitional periods should be implemented alongside the proposed new rules in order to allow for large multinationals to consider their structures and implement any changes as a result of the proposed new rules.
39. Paragraph 2.22 notes that nothing in the discussion document is intended to prejudice any of the disputes or investigations that are currently being undertaken by Inland Revenue. However, the Law Society recommends that officials clarify the impact of the proposed transfer pricing rules on existing transfer pricing investigations that Inland Revenue is currently undertaking.

#### **Conclusion**

40. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further please contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / [jo.holland@lawsociety.org.nz](mailto:jo.holland@lawsociety.org.nz)).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Kathryn Beck', written in a cursive style.

Kathryn Beck  
**President**