Tax Tips

The New Zealand BEPS Journey

March 2017

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A closer look at the Government’s recent discussion documents for the next steps in the BEPS journey for New Zealand

As we highlighted in our Tax Tips Alert: Next steps in the BEPS journey for New Zealand, the New Zealand Government released three consultation papers on 3 March 2017 setting out proposals to make it harder for foreign multinationals to shift profits outside New Zealand without economic justification.

The three Consultation Papers reinforce the Government’s commitment to the OECD’s Base Erosion and Profit Shifting (BEPS) Action Plan. The Government’s stated focus is on bolstering the New Zealand tax rules to ensure multinational companies doing business in New Zealand pay their fair share of tax. While the new proposals are mainly targeted at the large multinational companies, a number of proposed measures could also impact small to medium-sized companies.

In this Tax Tips, we build on our 3 March 2017 Tax Tips Alert and summarise what the proposed measures will mean for multinationals doing business in New Zealand and some practical ramifications that could follow.

The proposals as they stand are wide reaching and could significantly increase the compliance burden for taxpayers, including many who currently operate through low risk structures. Some of the proposals were signalled and are not totally unexpected. Others are new and arguably novel. A number of the proposals have borrowed aspects from Australia and the United Kingdom but appear to be more restrained than alternative measures some other countries are implementing.

In our view, the proposals as they stand are wide reaching and could significantly increase the compliance burden for taxpayers, including many who currently operate through low risk structures. Some of the proposals were signalled and are not totally unexpected. Others are new and arguably novel. A number of the proposals have borrowed aspects from Australia and the United Kingdom but appear to be more restrained than alternative measures some other countries are implementing.

However, in our view, some of the proposals risk having much wider ramifications than we consider are needed (and probably wider than policy officials intend). Ongoing dialogue and reflection by policy officials is vital as the detailed proposals are further developed, to ensure there is an appropriate balance with the practical impact of the proposals.

Submissions relating to the interest limitation, and transfer pricing and permanent establishment avoidance discussion documents are due by 18 April 2017. Submissions relating to New Zealand’s implementation of the MLI are due by 7 April 2017.

The three BEPS Consultation Papers covered the following topics:

- Strengthening our interest limitation rules.
- Transfer pricing and permanent establishment avoidance.
- New Zealand’s implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI).

The proposals as they stand are wide reaching and could significantly increase the compliance burden for taxpayers, including many who operate through low risk structures.
With the next Government Election coming up in September 2017, we expect the Government will want to make key design decisions on the policy proposals before the Election. Drafting tax legislation should occur once those key decisions are made. However, we consider it will be important for consultation (on the design and drafting) to continue throughout this period. In many respects, this is where the “rubber will hit the road” and where other countries have rushed the process resulting in taxpayers and advisers now facing unnecessary uncertainty.

The Consultation Papers state that the implementation date will be for income years starting on or after the legislative enactment date (except for some of the administrative measures which are intended to apply from enactment date). Given the significance of the proposals, we consider the implementation date should definitely not be any earlier than stated in the Consultation Papers. For some of the proposals, we consider the commencement date should be pushed further out.

**Strengthening our interest limitation rules: Arguably subtle, but definitely significant**

The Government has proposed arguably subtle, but definitely significant, changes to New Zealand’s thin capitalisation regime, including capping interest rates on related-party loans (instead of allowing normal transfer pricing rules and principles to apply). The Government’s primary concern is that some related-party loans have uncommercial terms and it is difficult under transfer pricing rules for Inland Revenue to challenge such terms as non-arm’s length.

Although we support the Government stance to not propose an EBITDA-based rule for thin capitalisation, in many situations the proposed thin capitalisation changes could have significant tax consequences for overseas owned entities operating in New Zealand (and in some cases outbound New Zealand groups).

1. **Limiting interest deductions on related-party loans**

The proposed response to concerns raised in the Consultation Paper is to cap the interest rate on related-party inbound funding exceeding NZ$10 million based on either:

- the highest credit rating of the ultimate parent or main operating entity of the multinational group, plus a margin (e.g. a one notch downgrade to highest credit rating); or
- if the New Zealand borrower has no ultimate parent, the implied credit rating of the New Zealand group (the “stand-alone” approach), with no margin.

In both cases, the proposals suggest the interest rate cap be calculated based on senior, unsecured debt on a maximum five year term (even if the actual debt term is longer).

No transitional rules, industry exceptions or grand-parenting are proposed to apply. When the rules commence, the interest rate on all existing related-party debt will need to be reviewed and potentially reset or the cap will bite. It is unclear as to how this will impact New Zealand taxpayers who have existing Advance Pricing Agreements (APAs) and we want to be sure it will not have an unintended retrospective effect.

Given the proposed changes to the transfer pricing rules (discussed below), we consider the rationale unconvincing as to why the proposed changes are considered necessary. In part, the rationale is that it is a quid pro quo to not having the EBIT limiting test. We consider the transfer pricing rules provide the appropriate place to challenge interest rates on related party borrowing. The Government acknowledges it is not aware of any other countries adopting a similar approach to this interest rate cap proposal.
We have started dialogue with policy officials in relation to the significant impact of these proposals and the usurping of accepted transfer pricing principles in this area. In our view, some form of safe harbour threshold is needed. An alternative is that taxpayers could have an ability to substantiate to Inland Revenue that the third party lending rate to the New Zealand operations would exceed the offshore parent’s borrowing rate and this rate can then be applied to the related party borrowing.

Our concerns with an interest rate cap for related party borrowing by New Zealand taxpayers include:

• The interest rate cap exercise requires determining the actual or implied credit rating for the New Zealand borrower’s ultimate parent, main operating entity and/or the New Zealand borrower. In many situations, this could be complex to calculate.

• The offshore lender’s own country transfer pricing rules still will apply to determine its taxable interest income, which could result in asymmetrical tax outcomes (i.e. double tax). This cannot be the correct tax policy answer.

• As the interest rate cap is a domestic anti-avoidance measure, it seems no relief from double taxation will be available through New Zealand’s double tax agreements (DTA) with treaty partners.

• Given the tiered credit rating approach, the interest rate on related-party loans could be lower than the interest rate on direct third-party funding.

• An NRWT mismatch will occur where there is a difference between the actual interest paid and the tax deductible interest (particularly in the light of the upcoming Non-Resident Financial Arrangement Income legislation).
2. Limiting the calculation of assets

Another subtle, but significant, impact for many taxpayer groups is the proposal that taxpayers will be required to measure their total assets net of non-debt liabilities, being all financial statement liabilities that are not debt for thin capitalisation purposes (less any interest-free shareholder loans).

This approach could have significantly different outcomes to the current measurement rules for a wide range of taxpayers, for example:

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<th>Co 3</th>
<th>Co 4</th>
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<tbody>
<tr>
<td>Cash</td>
<td>20</td>
<td>20</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Other assets</td>
<td>80</td>
<td>80</td>
<td>95</td>
<td>95</td>
</tr>
<tr>
<td>Interest bearing debt</td>
<td>50</td>
<td>45</td>
<td>50</td>
<td>45</td>
</tr>
<tr>
<td>Interest free debt</td>
<td>0</td>
<td>5</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>35</td>
<td>35</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Current thin cap ratio</td>
<td>38%</td>
<td>31%</td>
<td>47%</td>
<td>42%</td>
</tr>
<tr>
<td>Proposed thin cap ratio</td>
<td>67%</td>
<td>56%</td>
<td>75%</td>
<td>67%</td>
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In our view, this proposal significantly disadvantages taxpayers that have material creditor, provision or deferred tax liability balances. It seems to be based on the Australian thin capitalisation approach, but ignores key items that are carved out from the Australian equivalent concept of non debt liabilities (e.g. deferred tax liabilities). We consider more work needs to be done on the rationale for the change and what carve outs are needed if Government proceeds with the proposal. In our view, specific carve outs for some industries and businesses are needed (e.g. industries with significant rehabilitation requirements or other unique features, such as securitisation/securities lending, retirement village arrangements, etc).

Another proposed change that would materially impact some groups relates to the value of assets used in financial statements. Currently, the thin capitalisation rules allow taxpayers the choice to use the net current value of assets, regardless of the value method used in their financial statements, providing that the method is allowable under generally accepted accounting principles (GAAP). The Government is proposing to remove this choice and therefore limit asset values to those disclosed in the financial statements.

We consider the rationale expressed for this proposed change is too simplistic – basically, officials have assumed the best/most reliable value of assets are the ones in the financial statements. Early dialogue with policy officials on this issue has been encouraging and they are keen to understand the reasons why groups may not use current market values for significant assets in the financial statements (even if able to under GAAP).

We consider keeping the ability to use market values, even if not used in the financial statements, is very important – but we anticipate that additional requirements regarding independent (and reputable) valuations of those assets would be required by officials to bolster the current criteria. What officials are wanting to prevent is market values being asserted and used for thin capitalisation without adequate, robust and independent valuations to support those values.

On the basis of these two proposals alone, we expect most taxpayers will see their gearing levels pushed much closer towards, or beyond, the 60% safe harbour threshold. We understand that a key principle for policy officials is that there should be no thin capitalisation denials if the New Zealand group debt levels are not more than a commercial level of debt. We will be surprised if this key policy principle is not broken by the impact of some of these changes.

Currently the proposals suggest there will be no transitional rules or grand-parenting of existing arrangements and apart from a limited public-private partnership (PPP) type concession, there will be no industry based concessions. However, as noted above, early dialogue with policy officials indicates they are willing to listen and consider the issues raised.

If the proposals are enacted into law, we would expect most taxpayers to see their gearing levels pushed closer towards, or beyond, the safe harbour threshold.
3. Other matters

The discussion document also proposes a number of other thin capitalisation changes:

- The year-end calculation date method will be removed and taxpayers will be required to value their assets and liabilities on the average of either a daily or quarterly basis. This will add significant compliance costs. The level of extra work done for IFRS compliant/audited financial statements, rather than quarterly management accounts (e.g. provisions, etc) should not be underestimated.
  - Given there is already an anti-avoidance rule aimed at temporary fluctuations around thin capitalisation measurement dates, the concern underlying this proposal seems overstated in the vast majority of cases.
  - A suggestion would be to allow the use of year-end balances, but take the average of the start and end of the year. This would be much easier to ascertain, and more reliable as it would be values in year-end financial statements and ameliorate the underlying concerns.

- A de-minimis threshold of between $1-2 million interest expense will be extended to the inbound thin capitalisation rules for overseas owned groups. Taxpayers should welcome this move to reduce compliance costs. It is unclear how the proposed interest rate cap rules will interact with the de-minimis threshold.

- Certain PPP infrastructure projects will be able to exceed the existing inbound safe harbour threshold where third party non-recourse loans are obtained on commercial terms. We expect this rule to broadly mirror the Australian Arm’s Length Debt Test, albeit with limited application to a small number of taxpayers.

- Where firms are in the thin capitalisation rules due to being controlled by a group of non-residents “acting together” then interest on owner-linked debt will be non-deductible if the 60% safe harbour threshold is breached. This proposal will also remove the application of the 110% worldwide debt rule to prevent a portion of interest on owner-linked debt over the 60% threshold still being deductible. We assume owner-linked debt up to the 60% total debt threshold will still be deductible, but we are seeking clarification on this from officials. There is a limited grandfathering suggested for existing arrangements on this issue.

- The application of the owner-linked debt as it applies to trusts will be amended to include the value of settlements on the trust. Currently, the 5% ownership test cannot apply to a trust as the definition relies on the owner having an ownership interest, and settlements do not convey ownership interests.
Transfer pricing and permanent establishment avoidance

This particular discussion document contains a raft of measures aimed at strengthening the existing transfer pricing rules and deeming permanent establishments to exist in New Zealand for large multinationals in certain circumstances. Officials have said these changes are intended to be analogous to the OECD changes to Article 5 (Permanent Establishments) once the MLI takes effect. While the Government has indicated that it will not introduce a diverted profits tax (DPT) regime similar to the UK’s recent rules and rules proposed by Australia and France, the New Zealand proposal is to introduce a specific anti-avoidance tax rule to combat large multinationals that it considers have artificially avoided having a PE in New Zealand under current rules.

In essence, the proposed changes have the potential to achieve the same outcome as a DPT for a select group of large multinationals that earn significant revenue from New Zealand sources, yet pay a comparatively low level of tax given their domestic footprint. In proposing these changes, officials have confirmed that the policy intention is that the OECD Article 5 (Permanent Establishment) changes will apply to New Zealand, regardless of whether any of our tax treaty countries decide not to sign up to those specific BEPS related OECD changes. A number of these measures will be similar to the Multinational Anti-Avoidance Law (MAAL) recently introduced in Australia and the DPT rules Australia is currently enacting (but without the harsher penalty aspects – except where large multinationals trigger a set of administrative rules for uncooperative companies – refer below).

A number of other changes have also been proposed to strengthen the transfer pricing rules to align them with the OECD’s guidelines. Inland Revenue is also likely to be given additional powers to collect information and recover tax from large multinationals if they fail to meet their New Zealand tax obligations.

While the Government has indicated that it will not introduce a diverted profits tax (DPT) regime similar to those proposed by some other countries, the New Zealand proposal is to introduce a specific anti-avoidance tax rule to combat large multinationals that it considers have artificially avoided having a PE in New Zealand under current rules.

Widening the PE net

The concept of a permanent establishment (PE) is important to the New Zealand tax base as it establishes New Zealand’s taxing rights in respect of a non-resident’s taxable income. The definition of PE varies across New Zealand’s network of double tax agreements. However, a non-resident will generally have a PE where there is sufficient presence in New Zealand.

The Government’s concern is that sales activities conducted by associated entities from the non-resident seller are difficult to trigger a PE in New Zealand for the non-resident company under the current rules.

Under the OECD’s draft MLI text, the existing agency PE rules in New Zealand’s treaty network will be tightened to deem a PE to arise if a non-resident entity “habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise” via an intermediary. Most of these changes have been signalled for some time and are already broadly incorporated into some of our tax treaties (e.g. Australia).
However, as not all of New Zealand’s treaty partners are expected to sign up to the PE section of the MLI, the Government has proposed that the PE anti-avoidance provisions would apply, regardless of whether the new revised OECD model changes will be incorporated into a particular treaty under the MLI process.

The proposed rules are intended to capture large multinationals that meet all of the following criteria:

- Are part of a global group that has greater than €750 million (c. NZ$1.15 billion) annual turnover.
- Sell their products directly to New Zealand customers via an off-shore entity.
- Utilise New Zealand-based staff to support the sales function, through a New Zealand subsidiary, branch or “dependent” persons or entities contracted to an off-shore entity.
- Do not record the New Zealand sales, or do not record a commercially appropriate proportion of New Zealand sales in their New Zealand accounts.
- The arrangement defeats the purpose of the updated tax treaty PE provisions.

In the Government’s view, “activities designed to bring about a particular sale should potentially result in a deemed PE.” The key question is how this concept will be defined in the draft legislation. The risk of uncertainty and vague definitional wording is real – and is being experienced in Australia currently. Detailed clarification as to the proposed threshold to be adopted in determining whether an activity brings about a particular sale will be vital. Comments in the document (and reinforced to us by officials) indicate the intention is to target activities very closely linked to the sale, and not marketing services or back office support services. However, this will remain a key area of focus and clarification as the proposals are developed further.

Another core issue, however, lies not necessarily in the existence of a PE but rather the calculation of the resulting tax outcome for New Zealand. The Government has stated that they “expect that the application of these principles will result in a fairly significant amount of the sales income being attributable to the deemed PE in most cases. We also expect a material amount of net taxable profit to remain in the PE after the deduction of related expenses.”

The attribution of profits to a PE is a contentious issue globally, with New Zealand making an explicit reservation against the authorised OECD approach (AOA) included in the revised Article 7 (Business Profit) in the 2010 update of the OECD Model Tax Convention. In doing so, New Zealand has opted to follow the historic approach to profit attribution for a PE, which can result in profit outcomes that are not necessarily “arm’s length” under general transfer pricing principles or equivalent to the profit outcome for a subsidiary in New Zealand. For example, there can be no implied royalties for intellectual property (IP) used by a PE in New Zealand if the foreign entity has IP ownership, nor can management or support services be charged with a profit element. This issue is likely to be further exacerbated when no DTA exists as New Zealand’s domestic attribution rules may further limit the ability for transfer pricing principles to be used to determine taxable profits. This could potentially lead to cases where significant profits are taxed in New Zealand even though New Zealand activities are limited to a routine sales function.

Assuming a PE is deemed to exist under these proposals, we expect the issue of attribution to be the area of focus most needed by Inland Revenue, and the biggest area of uncertainty and concern for large multinationals.
We are highlighting to officials the need for clarity around the attribution methodology of PEs that New Zealand is intending to apply. We understand officials agree that the intended end outcome should not seek to tax more than the economic value that is created by the actual activities in New Zealand. This will remain an area of uncertainty for some time we expect.

We are also requesting clarity that simply having a deemed PE in New Zealand under these proposals should not automatically trigger a shortfall penalty, especially if the multinational considers it already has returned the correct amount of taxable income in New Zealand through associated entities related to the economic value of sales activities conducted in New Zealand.

Finally, a new source rule has been proposed to treat any income as having a source in New Zealand if it can be attributed to a New Zealand PE under any tax treaty, or under an equivalent definition which will be inserted into New Zealand’s domestic tax law to ensure that the same outcome arises if no tax treaty applies. This means that income attributable to a PE in New Zealand will be consistently treated as taxable in New Zealand regardless of the jurisdiction of the non-resident.

We understand officials agree that the intended outcome should not seek to tax more than the economic value that is created by the actual activities in New Zealand. Our concern is that the draft legislation for deemed PEs, combined with the attribution rules and guidance, will be an area of uncertainty for some time.
Strengthening the transfer pricing rules

Under existing transfer pricing rules, cross border associated party transactions must be priced at arm’s length, taking into consideration the legal form of the transactions. Although there are no mandatory documentation requirements, Inland Revenue expects taxpayers to prepare contemporaneous transfer pricing documentation to support the pricing of these transactions.

In this discussion document, the Government has proposed changes that will further align New Zealand’s transfer pricing legislation with the OECD’s transfer pricing guidelines, BEPS recommendations and Australia’s new transfer pricing rules including:

- transactions will now be explicitly able to be priced by Inland Revenue for transfer pricing adjustments based on the economic substance of the arrangement if this differs from its legal form
- granting Inland Revenue with the ability to disregard and/or reconstruct a transaction if the legal form of the transaction is not aligned with the commercial reality
- an express reference to the OECD transfer pricing guidelines in the legislation
- shifting the burden of proof to taxpayers to encourage preparation of higher quality transfer pricing documentation (without introducing mandatory documentation requirements)
- extending the statute bar in respect of transfer pricing matters to seven years
- broadening the rules to capture investors that “act together”, such as private equity investors.

In our view, the above changes represent a fundamental shift in New Zealand’s transfer pricing rules. However, the proposals mostly reflect the reality of the enforcement approach adopted by Inland Revenue over the past few years, and will further support Inland Revenue’s efforts to impose more stringent requirements in respect of transfer pricing compliance.

While it has been widely expected that Inland Revenue would follow OECD’s recommendations set out in Action Plans 8 to 10 of the BEPS Project, the shift from legal form to economic substance is a significant change to New Zealand’s existing legal framework. It is important to note that Inland Revenue is already focusing on economic substance in transfer pricing audits, so the proposed change to economic substance will likely make it easier for Inland Revenue to successfully challenge transfer pricing structures in the courtroom if the legal form of a structure does not reflect Inland Revenue’s view of the economic reality.

The focus on economic substance together with the shift of the burden of proof to the taxpayer will no doubt send a clear message to multinational companies that transfer pricing structures need to be defendable from a commercial perspective and well documented (from both New Zealand and the counter-party jurisdiction's perspective) and taxpayers should be prepared for increased scrutiny on the substance of the transacting party and how they fit into the overall global supply chain.

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In the light of this, we consider that more clarity and guidance is needed to enable taxpayers to determine what is required to discharge the burden of proof which now falls on the taxpayer. We will also encourage the Government to consider introducing simplification measures to ensure that the compliance burden does not outweigh the tax at risk in relation to smaller taxpayers or those with low risk structures.

The extension to the statute bar from four to seven years was proposed due to the length of time required to investigate transfer pricing matters. If implemented, this proposal will reduce certainty for taxpayers. Given the increase to Inland Revenue’s information gathering powers and the shift in the burden of proof, we question whether the proposed extension of the statute bar is necessary. In our view, providing more substantive guidelines in relation to timeframes for risk reviews, audits and APA negotiations would be more beneficial in assisting taxpayers with an understanding of Inland Revenue’s processes and providing greater certainty.

**Administrative measures**

The discussion document proposes a number of administrative measures which will give Inland Revenue greater power to collect information and issue re-assessments.

The proposed measures will only apply to large multinationals whose annual global turnover exceeds €750 million. The measures are intended to make it easier for the Commissioner to assess multinationals where there is significant and persistent “non-cooperation”. A key question will be the definition of this concept in the legislation.

The consequences of such classification is severe as it enables Inland Revenue to issue assessments prior to completion of the statutory disputes resolution process, and enables the Commissioner to require payment of disputed tax as early as 90 days after the accelerated assessment is issued (instead of at the end of the disputes process), or within 12 months of the issue of a Notice of Proposed Assessment (NOPA) (which could be before an assessment is issued). These proposals would only apply to disputes in relation to transfer pricing, New Zealand sourced income or PE avoidance issues.

The discussion paper notes that a warning will be provided, followed by an opportunity to co-operate. The decision to classify a taxpayer as non-cooperative would be made at a sufficiently high level within Inland Revenue and is aimed at “significant and persistent” non-cooperation.

The circumstances mentioned in the Discussion Document as to when a large multinational could be treated as non-cooperative do not appear to be consistent with the objective of applying only to significant non-cooperation. Failing to provide information to determine the arm’s length amount is sufficient, and so is the failure to respond to Inland Revenue correspondence, which, on the face of it, could apply where a taxpayer is not legally obliged to respond. We have raised with officials the need for the definitions to reflect the intended high threshold.

Given the severity of the consequences of non-cooperation, we consider that a consistently high threshold should be adopted and that it should only apply to the failure to meet a legal obligation imposed elsewhere in the tax legislation.

It has also been proposed that any tax payable by a member of a large multinational would be collectible from any wholly owned subsidiary of the multinational in New Zealand. This proposed measure, which enables Inland Revenue effectively to pierce the corporate veil, will likely have significant repercussions on affected “uncooperative” taxpayers (e.g. the creation of an unexpected liability, which can have an adverse impact on loan covenants, or residual tax liabilities for other members of the group when New Zealand subsidiaries are sold).

New measures are proposed to extend Inland Revenue’s information gathering power to information held by group members located outside New Zealand. Under this proposed measure, the New Zealand subsidiaries will be required to provide information held by their overseas parents and sister companies to Inland Revenue. This raises issues regarding how the New Zealand subsidiary can demonstrate that an overseas entity does or does not have information, and how Inland Revenue can enforce if the matter is unclear.

If taxpayers continue to ignore Inland Revenue activities and requests for information, then it has been proposed that the Commissioner be allowed to impose a civil penalty of $100,000 on large multinationals that do not comply with a formal information request. This civil penalty would be imposed instead of a criminal fine of up to $12,000. This is a significant change given that imposing a civil penalty requires a lower standard of proof (balance of probabilities) as compared to a criminal penalty (beyond reasonable doubt). Officials have confirmed it is not intended that this penalty could be imposed on employees.
We note that section 21 of the Tax Administration Act 1994 already allows the Commissioner to disallow a deduction for an offshore payment where a taxpayer fails to adequately respond to a formal information request concerning the payment. The taxpayer is unable to challenge the disallowance, and information that was requested, and not provided, is not admissible in challenge proceedings.

The discussion document has proposed that section 21 be expanded to allow the Commissioner to deem an amount of income as New Zealand-sourced income where a large multinational has failed to respond to an information request under that section. In our view, if the section is to be amended to apply to income as well as deductions, it needs to be redrafted as a whole to be more balanced and reasonable to taxpayers.

It is not proposed that a taxpayer be treated as non-cooperative for actions before this provision applies.

**Multilateral Instruments**

The final consultation paper sets out New Zealand’s thinking on its implementation of the OECD’s Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. The paper sets out the provisions of the MLI that New Zealand intends to adopt and the DTAs that New Zealand would like the MLI to cover. Current indication is that New Zealand will adopt all provisions (i.e. beyond the minimum standard) that are applicable and for the MLI to generally apply to New Zealand’s treaty network unless New Zealand knows that the other treaty partner is not intending to sign the MLI or the treaty is under renegotiation.

Officials’ embracive approach to the MLI is not surprising as a number of the provisions are consistent with the existing treaty positions adopted by New Zealand in its treaty network. In particular, New Zealand has often adopted positions that look to bolster source taxation (e.g. the PE article). Further, New Zealand has also been adopting a number of the other treaty-abuse provisions in its more recently negotiated tax treaties.

Of particular interest is the proposed position for New Zealand to adopt the principle purpose test only in relation to the treaty anti-abuse rules. We are pleased to see there is no intention to adopt the more complicated “simplified limitation on benefits” (LOB) clause which sets out a number of black-letter tests that a person must satisfy before treaty benefit is created. In our view, the LOB approach could be overly restrictive and can deny treaty benefits to a person even though there is no intention of treaty abuse.

While the consultation paper provides useful insights on where we can expect New Zealand’s treaty network to initially move to, it could still be months before we have a clear picture of what the final treaty positions will be. This is because a DTA will only be amended where both treaty parties opt for the same MLI provisions. While we understand New Zealand has entered into initial discussions with other jurisdictions to get a better sense of the likely positions to be adopted, those discussions are generally confidential. Taxpayers will therefore not know the final position to be adopted in a particular DTA until the other country has also signed the MLI.

Despite the uncertainty, it will be strongly advisable for offshore businesses operating in New Zealand to reconsider their exposure to New Zealand tax as the proposals are further refined. This is because the parameters of what would be considered a PE in New Zealand will likely still change under the other proposals in the discussion documents irrespective of whether or not the home jurisdiction of the offshore business adopts the relevant MLI provisions in the light of the proposals contained in the discussion document on PE avoidance as discussed above. Those proposed changes are intended to have the same impact for the offshore business as those proposed by the MLI but it will get there via New Zealand’s domestic law.

If you would like to discuss how the proposed changes might impact the way you do business in New Zealand, or wish to discuss aspects of the submission we intend making or would like assistance in making a submission on the proposed changes, please reach out to your PwC adviser.