INTERNATIONAL BAR ASSOCIATION

RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION

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NEW ZEALAND

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1. BASE EROSION AND PROFIT SHIFTING PROJECT

1.1 Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018

New Zealand has enacted legislation, the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 (the **Act**) which made a number of amendments to the New Zealand tax system in line with the OECD's recommendations on base erosion and profit shifting. These amendments generally apply to the income years starting on or after 1 July 2018.

The amendments were discussed in some detail in the IBA National Report prepared in June 2018 and so will not be fully canvassed here. By way of broad overview, however, the amendments include:

- <u>Changes to the permanent establishment rules</u>: The amendments include a new "deemed source" rule, which deems an amount of income to have a New Zealand source if the income can be attributed to a permanent establishment in New Zealand. The Act also introduced a new anti-avoidance rule that applies specifically to members of a large multinational group with at least €750 million consolidated global turnover.

- <u>Thin capitalisation</u>: There have been a number of amendments to New Zealand's thin capitalisation regime, in order to incorporate the OECD's BEPS recommendations and align New Zealand's thin capitalisation regime with those of other countries.

- <u>Interest limitation for high BEPS risk taxpayers</u>: New transfer pricing rules limit interest deductions on in-bound related party loans for high BEPS risk taxpayers. Broadly, these new rules require pricing of related party debt based on a restricted credit rating approach and on the basis that certain "exotic" features of the debt are to be disregarded.

- <u>Further transfer pricing amendments</u>: The Act incorporates broader amendments to New Zealand's transfer pricing regime, to place greater weight on the economic substance and actual conduct of the parties, rather than the terms of any legal contract. The onus of proof in transfer pricing matters is shifted onto the taxpayer and the time bar for transfer pricing adjustments is extended to 7 years in some circumstances.

- <u>Hybrid mismatch rules</u>: The Act introduces new hybrid and branch mismatch rules applying to arrangements where there is some degree of association between the parties to that arrangement, or whether the arrangement is structured to take advantage of a hybrid mismatch.

These changes will be of relevance to many international investors, who may find that previous structuring arrangements require reconsideration.

1.2 Digital services tax

In February of this year, the New Zealand Government announced its intention to consult on changes to New Zealand's tax rules "to ensure that multinational companies … pay their fair share of tax" in New Zealand. The press release noted New Zealand's involvement in continued efforts at the OECD level to develop an international solution to the taxation of the digital economy, but indicated that the Government would be considering a domestic solution in the interim.

Based on the design of similar taxes in other jurisdictions, it appears likely that a digital services tax would be designed as an excise tax and would be levied at a rate of between 2 and 3% on gross revenues from certain digital platforms. Depending on the design of the tax, it could raise revenue of between $30 million and $80 million – a relatively modest figure in comparison to New Zealand's $2.7 billion digital economy.

Since the initial consultation was announced, the Australian Government has announced that it is abandoning its proposed digital services tax in favour of engaging at the OECD level. The impact of that announcement remains to be seen, however the New Zealand Government had previously emphasised the benefits of aligning New Zealand's position on any digital services tax with Australia's.

A discussion document outlining the proposed digital services tax (if any) is expected to be released in May 2019.

2. INTERNATIONAL TREATY DEVELOPMENTS

2.1 Multilateral Convention

New Zealand has ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (**MLI**). The instrument of ratification was deposited on 18 June 2018 and the MLI entered into force on 1 October 2018. The MLI will impact almost all of New Zealand's double tax agreements save those with the US, Taiwan and Samoa respectively.

The New Zealand Inland Revenue Department is presently working with the Australian Tax Office to formalise a practical administrative approach for non-individual dual residents that will seek to provide certainty and minimise compliance costs for eligible taxpayers. Continuing work in this area forms part of the Single Economic Market agenda between Australia and New Zealand, which seeks to create a seamless trans-Tasman business environment.

2.2 Court of Appeal upholds challenge to information request

The New Zealand Court of Appeal recently upheld a challenge to notices issued by the Commissioner of Inland Revenue in New Zealand following an exchange of information (**EOI**) request from the Korean National Tax Service (**NTS**). The challenge was brought by Chatfield & Co Limited, the New Zealand accountant for a number of companies associated a Korean citizen living in New Zealand who was the subject of an NTS investigation in Korea.

Article 25 of the double tax agreement between New Zealand and Korea requires that information exchanged by a competent authority is "necessary for carrying out… the domestic laws of the Contracting States" (in contrast to more modern agreements, which require only that the information be "foreseeably relevant"). However, evidence presented at trial established that, when determining whether to comply with the EOI request, the competent authority for New Zealand failed to apply this legal test, referring at various points in his decision to both a "necessary" and a "relevant" threshold. For this reason, the Court of Appeal held that the decision of the competent authority to issue information requests to Chatfield & Co Limited was unlawful.

While the Commissioner of Inland Revenue was unsuccessful in this case, the Court of Appeal's decision sets a relatively low bar for New Zealand's competent authority to meet when considering whether to take action in respect of an EOI request. In particular, the Court of Appeal accepted the Commissioner's position that, absent some indication of irregularity, the competent authority could not be expected to inquire into the basis for an EOI and furthermore, would generally be entitled to take an assertion by the requesting authority that the information was "necessary" at face value. It is not clear, at this stage, when the competent authority will be considered to have been put on notice regarding an irregularity (for example, whether an EOI request from a less-than-scrupulous revenue authority would, of itself, merit further inquiry).

The Commissioner of Inland Revenue has sought leave to appeal the decision to the Supreme Court of New Zealand.

2.3 Double tax agreements

New Zealand signed a new double tax agreement with the People's Republic of China on 1 April 2019 (not yet in force). The new agreement is intended to promote economic ties between the two countries. Key changes include reductions in the rate of withholding imposed on certain dividends and the incorporation of new anti-BEPS measures.

New Zealand's double tax agreement with Hong Kong has also been updated, widening the exchange of information provisions to enable the automatic exchange of information (**AEOI**). Under the AEOI initiative, New Zealand financial institutions are required to review their accounts and compile information, which is then supplied to the Inland Revenue Department.

3. DOMESTIC LAW DEVELOPMENTS

3.1 No capital gains tax for the foreseeable future

Prime Minister Jacinda Ardern ruled out introducing a capital gains tax at any point during her tenure. The Prime Minister's decision ran contrary to the policy platform for her New Zealand Labour Party since 2011. In doing so the Prime Minister rejected the recommendation of the majority of the Tax Working Group, which was appointed by the Government to examine and explore possible improvements to the New Zealand tax system following the 2017 general election.

In addition to recommending the implementation of a capital gains tax, the Tax Working Group made a number of recommendations regarding reductions in some personal income tax rates and the taxation of business (including the re-introduction of depreciation on buildings, revisiting the deductibility of black-hole expenditure and simplifications to the fringe benefit tax regime). However, the Tax Working Group was careful to note that the extent of any amendments in these areas would be dependent on the scope of (and therefore, the revenue raised by) any capital gains tax. Without the additional revenue derived from a new capital gains tax, it is unclear how the reforms recommended by the Tax Working Group would be funded.

3.2 GST to be imposed on imports of low-value goods ("Amazon tax")

A bill has been introduced into the New Zealand Parliament that would require offshore suppliers to register, collect and return New Zealand GST on goods valued at or below $1,000 that are supplied to consumers in New Zealand. Offshore suppliers would not be required to return GST on supplies to New Zealand GST-registered businesses and would not be required to provide tax invoices. The proposed amendments are broadly similar to those recently introduced in Australia.

The changes are expected to come into effect from 1 October 2019.

3.3 Taxpayer wins rare victory in tax avoidance case

In November 2018, the High Court released its decision on the long-running dispute between Frucor Suntory New Zealand Limited and the Commissioner of Inland Revenue. The taxpayer in that case successfully rebutted an allegation that its use of convertible note financing to fund its New Zealand business was a tax avoidance arrangement. The judgment addresses a number of significant matters:

- It accepts that Parliament would have contemplated that taxpayers would ordinarily be entitled to interest deductions on debt instruments, if set at an arm's length rate.
- It confirms that the presence of unorthodox features in an internal arrangement between group companies will not necessarily be regarded as "artificial" features in a tax avoidance analysis – it is the tax outcomes that must be considered.
- It reinforces the traditional separate legal entity approach in an international tax context.

The Commissioner of Inland Revenue has appealed the decision. A hearing on the appeal is scheduled to take place in 2020.