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An own goal in the making? The implementation of BEPS in New Zealand

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New Zealand is a country with a significant land mass and a small population, located in the South Pacific. Although its ethnic origins were Māori and European, today New Zealand is a truly Asian country with strong links to China, Japan, Singapore, the Middle East and elsewhere, in addition to our traditional trading and investment partners in Australia, Canada, the European Union, and the USA. New Zealand's economy has a heavy emphasis on primary production (particularly dairy). It is said that New Zealand is as far as one can get from everywhere else in the world, and still buy a decent coffee. It is a remote, open, economy, and a net capital importer with a sophisticated broad-based low rate tax system. The fiscal pressures and economic inter-relationships faced by New Zealand in terms of trade and investment are quite different to many other countries. How can the OECD's politically-driven base erosion and profit shifting (BEPS) initiatives be expected to impact on New Zealand corporates operating overseas and multi-nationals with operations in, or sales to, New Zealand?

New Zealand's tax environment – overview

New Zealand has long-established and sophisticated income tax and indirect tax (GST) regimes. It is characterised by having a broad base, reasonably low marginal rates of taxation for individuals and by its (relatively speaking) lack of exceptions and exemptions. The tax policy process conducted by the Inland Revenue Department (primarily) and the New Zealand Treasury is well-resourced and sophisticated. Policy changes are typically made after meaningful engagement with taxpayers and industry groups, as part of the "generic tax policy process". New Zealand's unicameral legislature means that law changes often occur more quickly, and with less Parliamentary scrutiny, than in other jurisdictions. In general, New Zealand is as advanced as any OECD country in identifying and countering unacceptable tax practices. The income tax and GST regimes represent a principled yet pragmatic balancing act, suitable for a small, capital-importing nation.

BEPS in New Zealand

BEPS has been described by the OECD as a "global problem which requires global solutions". The OECD considers that there are gaps and mismatches in the tax rules which enable multi-national enterprises (MNEs) artificially to shift profits to low or no-tax locations where there is little or no economic activity.

The reality is that the "gaps" and "mismatches" in the tax rules are, arguably, the outcome of a long process of countries acting in their own self-interest, and of regional (and global) tax competition.

New Zealand's response to BEPS has been to focus on four Action Points in particular:

- Hybrids
- Tax treaty abuse
- Transfer pricing, and
- GST and the cross-border supply of services, intangibles and goods.

New Zealand's international tax policy settings are considered generally robust, though there are numerous reforms being proposed with effect on non-resident investors and the cost of capital for New Zealand borrowers in particular. These include:

- Neutralising the effect of hybrid mismatch arrangements (Action 2).
- Limiting base erosion via interest deductions (Action 4). Worryingly, the proposed solution in terms of thin capitalisation changes is that worldwide interest payments will be calculated for multinational enterprises, and allowable tax deductions would be allocated on a country-by-country basis relative to the revenue generated in that country. Plainly, for a country with a small population base and high interest rates such as New Zealand such a proposal has the potential to affect New Zealand in a disproportionately harsh manner.
- A large number of non-resident withholding tax rules (and associated approved issuer levy rules) are also proposed to be changed which, as currently proposed, would have the net effect of increasing the tax charge on a number of borrowing arrangements (including joint ventures with off-shore firms) from the current two percent to ten percent.

New Zealand is also looking at reviewing the taxation of foreign trusts (although this is strongly resisted by the foreign trust advisory sector) and by improving the quality and usefulness of tax information via administrative measures (enhanced compliance measures) to:

- Require large corporates to file income tax returns earlier so that information can be analysed and shares identified sooner
- Require large corporates to disclose additional information that is readily available to them in a standard format so that it can be quickly analysed
- Introduce a voluntary code of practice for large corporates which would likely include having good tax governance, a transparent relationship with Inland Revenue and avoiding aggressive tax planning.

Automatic exchange of information

New Zealand has joined with the G20 and the automatic exchange of information initiative, and has made a political commitment to begin exchanging information on a voluntary basis from 2018 and on a mandatory basis in 2019, adopting a timeline consistent with Australia. That information exchange, which will be based on the United States Foreign Account Tax Compliance Act (FATCA) requirements, will require financial institutions to undertake enhanced due diligence procedures on account holders and then to report ownership and further account information to Inland Revenue, to be automatically exchanged with applicable treaty partners.

Tax treaty upgrades

New Zealand's current network of international tax treaties will also be upgraded and in 2015 new double tax agreements or protocols are to be agreed with Korea, Australia, Norway, Slovak Republic, China, Portugal and Samoa. In addition, New Zealand is supporting The Multilateral Convention on Mutual Administrative Assistance in Tax Matters as its primary exchange of information mechanism. Officials have stated that New Zealand does not anticipate entering into additional tax information exchange agreements (TIEAs) beyond the existing programme of San Marino, Antigua and Barbuda, Aruba, Grenada, Macau and Monaco.

Increased transfer pricing audit activity

At a domestic level, transfer pricing scrutiny has increased dramatically in New Zealand with Inland Revenue undertaking comprehensive fact gathering, including:

- Interviewing staff in New Zealand and overseas to verify the functional analysis that has been presented in transfer pricing documentation
- Detailed questioning and request for information from other tax authorities to understand the entire supply chain across all relevant countries
- Request for the provision of all business emails for particular staff over a specified period of time
- Requests for information allowing the analysis of profit margins derived at each step of the supply chain offshore
- Review of other available information to confirm activities undertaken by staff.

The route being undertaken in terms of Action 4 (transfer pricing to limit base erosion by interest deductions) is also anticipated to include the introduction of country-by-country reporting for New Zealand subsidiaries of foreign-based multinationals of significant size. The Australian threshold for country-by-country reporting is A$1billion, but the New Zealand threshold has not yet been determined. A threshold of the NZ$ equivalent of the Australian threshold would exclude all but a handful of New Zealand businesses.

Conclusion

In this writer's view, the BEPS initiatives are welcome at a political level, but the details of the changes being made in certain key areas (and the speed with which changes could be implemented), when combined with the specific actions being taken in other jurisdictions, could result in unwelcome and harmful effects for New Zealand as a nation. New Zealand has had prior experience of this when it implemented its now-repealed controlled foreign company regime in 1986. As a net capital importing nation, heavily reliant on trade and ready access to markets, anything which drives up the cost of capital (such as increases in non-resident withholding taxes on interest, from two percent to ten percent), or forcing symmetrical tax treatment of hybrid instruments (for example, aircraft lease payment arrangements), or denying interest deductions to a greater extent under revised thin capitalisation rules, will all operate as a net additional cost to doing business in New Zealand. MNEs and other large investors (such as pension funds investing in forestry and infrastructure assets) might simply go elsewhere, and not invest at all. The actual cash cost of New Zealand being seen as a good global citizen at a political level, could ultimately fall on the New Zealand taxpayer increasing the cost of doing business and reducing competitiveness. If that occurred, the implementation of BEPS would indeed be an "own goal", for this country.

This article was written by Neil Russ, partner in our tax team, for Corporate Livewire's Expert Guide – Tax 2015.

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