Inland Revenue
Te Tari Taake

THE TREASURY
Kaitohutohu Kaupapa Rawa

Aide Memoire
Briefing note

Reference: BN2017/568
T2017/2450

Date: 7 November 2017

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Minister of Revenue (Hon Stuart Nash)

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Subject: **'Paradise Papers' information leak**

This note relates to the recent media articles on the latest releases of the 'Paradise Papers' regarding the Bermuda-based legal firm, Appleby. This involved the leaked release of numerous financial documents outlining how some multinationals and investors are avoiding tax by investing in offshore havens.

Inland Revenue is currently working with the relevant agencies and international treaty partners to understand if any New Zealand taxpayers have had contact with Appleby.

Key Messages

- Media reports on the leak have not identified any New Zealand links that we were not previously aware of, although media has repeated links made at the time of the Panama Papers release;
- Inland Revenue is continuing to work with treaty partners on the released information;
- We will keep Ministers updated on any major developments (subject to tax secrecy rules).

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Information Disclosure and Base Erosion and Profit Shifting

- The OECD has led a program to improve information sharing to reduce the ability of taxpayers to hide their activities offshore to enable tax evasion or other elicit activity (including Automatic Exchange of Information). New Zealand has actively supported this effort and is implementing these changes.

- The foreign trust inquiry led by John Shewan identified gaps in disclosure rules for foreign trusts which have since been closed. Inland Revenue will begin to actively share information on foreign trust activities which should greatly reduce their ability to be used to hide elicit activity.

- New Zealand has actively cooperated with the OECD's Base Erosion and Profit Shifting (BEPS) program to tighten up our rules to reduce the ability of multinationals to reduce their tax. These include:

  Measures already enacted (raising approximately $100 million per year)

  - Strengthening how we apply withholding tax to interest payments paid to non-residents;

  - Charging GST for digital downloads from offshore

  Measures currently in progress (expected to raise an additional $200 million per year)

  - Restricting the amount of interest that can be deducted by a New Zealand company when paid to an offshore related person;

  - Strengthening transfer pricing rules;

  - Introducing a rule to counter some avoidance of permanent establishments (to capture in the tax base more sales by non-residents to New Zealand residents);

  - Measures to counter the interaction of different countries tax rules that result in the ability have some income escape tax anywhere (hybrid mismatches)

  Officials will report to you on these additional measures this week.

Discussion

The key themes canvassed in this note are:

- ***Use of Tax Havens and Exchange of Information developments***

  The key concern arising from the use of tax havens is secrecy.

  In recent years there have been huge international developments in exchange of information, with all tax havens now eliminating secrecy and agreeing to exchange tax-related information with other jurisdictions.

  New Zealand's network of exchange of information arrangements in tax treaties currently extends to over 100 jurisdictions, including all of the tax havens mentioned in connection with the Paradise Papers.

- ***New Zealand Tax Transparency***

  Following the implementation of the Shewan Inquiry recommendations, foreign trusts are subject to comprehensive disclosure obligations.

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The previous Government agreed that foreign trusts and limited partnerships should be subject to the hybrids rules, meaning that New Zealand will look to tax them to the extent that they are not paying tax elsewhere.

- ***Base Erosion and Profit Shifting (BEPS) structures***

  New Zealand proposals to prevent base erosion and profit shifting based on the OECD Action Plan are well advanced. We are reporting to you on those proposals before the end of this week. They include new hybrid mismatch rules, rules to limit interest deductions, and stronger transfer pricing and permanent establishment rules. The aim is to introduce a bill containing these measures next month.

  EU directives that are also based on the OECD Action Plan together with changes to Irish law and proposed changes to US law should impact the use of structures by US multinationals [redacted] In particular, US multinationals should pay more tax in the US on their offshore activities.

Use of Tax Havens and Exchange of Information developments

The term 'tax haven' is often used in reference to low (or no) tax jurisdictions. More correctly, however, it refers to low tax jurisdictions that operate on the basis of secrecy.

If a low tax jurisdiction offers secrecy in tax matters, information relating to an entity that a taxpayer establishes in that jurisdiction is effectively 'hidden' from the taxpayer's home jurisdiction. This creates a significant incentive for the taxpayer to not declare income or to misrepresent the nature or value of business transactions derived or conducted through the entity, in their home jurisdiction.

In recent years, the G20 and OECD have been at the forefront of international efforts to eliminate tax secrecy, by requiring the global implementation of standards for full transparency and exchange of information in tax matters. This involves ensuring that jurisdictions enter into tax treaties that provide for exchange of information for tax purposes. It also involves ensuring that jurisdictions have legal and administrative frameworks in place to access the information needed to verify tax compliance. This work is well advanced, and virtually all jurisdictions that had previously been identified as tax havens have eliminated their secrecy rules and are now regularly exchanging tax-related information.

As an OECD member, New Zealand has supported and been involved in the tax secrecy work. New Zealand itself currently has tax treaty exchange of information relationships in place with over 100 jurisdictions, and continues to build its network as more jurisdictions come to light as operating international financial centres. The tax treaty network includes double tax agreements, tax information exchange agreements, and a multilateral tax assistance convention.

A low tax rate on its own does not necessarily signify tax avoidance or evasion. It is a sovereign decision for each country to make as to how much revenue it needs to raise through taxation, and the tax system that it should adopt to raise that revenue. In addition, there can be valid reasons for business structures to include one or more entities located in a low tax jurisdiction. For example, a joint venture or private equity firm involving investors from several jurisdictions may wish to establish an entity in what is termed a 'tax neutral' jurisdiction to establish a vehicle through which to make an investment. Provided that each party to the joint venture or investor in the private equity firm declares their share of the income in their home jurisdiction (as required), and pays the correct amount of tax in that jurisdiction, no 'mischief' has taken place.

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New Zealand tax transparency

New Zealand's involvement in the Panama Papers was largely limited to the use of tax transparent entities, particularly foreign trusts. However, limited partnerships are another vehicle that provide tax transparency.

Foreign trusts

New Zealand taxes trusts based on the residence of the "settlor", being the person or persons that contributed the trust property. This ensures that New Zealand residents cannot put money into trusts established overseas to avoid New Zealand tax. Under current settings, this also means that a trust with no New Zealand settlor is not subject to tax in New Zealand on its foreign-sourced income. However foreign jurisdictions often base their tax treatment on the residence of the trustee, not the settlor. This means that income retained by a foreign trust can be non-taxable in both New Zealand and overseas.

In response to the Panama Papers, the previous Government accepted the major recommendations of the Government Inquiry into Foreign Trust Disclosure Rules, led by John Shewan. These recommendations introduced comprehensive disclosure rules for foreign trusts, which are expected to deal with the issue of foreign trusts being used to 'hide' assets. The disclosure rules are now in effect and Inland Revenue has received approximately 3,500 applications for registration from foreign trusts.

The disclosure changes did not alter the underlying tax treatment of foreign trusts. More recently, the previous Government announced that foreign trusts would be subject to the hybrids rules, which form part of BEPS project. This decision would mean that New Zealand would tax the income of foreign trusts to the extent that it is not subject to tax in another jurisdiction (subject to a small *de minimis* threshold).

The details of the proposal are still being worked through, but officials consider that these rules would subject some, but not all, foreign trusts to New Zealand tax. However, the interaction between foreign trusts and the hybrids rules is very complex and we intend to cover this further in the broader BEPS report we will provide you later this week.

Limited partnerships

Limited partnerships are transparent for New Zealand tax purposes, meaning the income derived by the partnership is deemed instead to be derived by the partners in their relevant shares. Like foreign trusts, this means that New Zealand does not tax foreign-sourced income of non-resident partners. Because a New Zealand limited partnership is a separate legal person, overseas countries may treat it like a company. This can result in a double non-taxation of the limited partnership's income.

The Registrar of Limited Partnerships is the Registrar of Companies holding office under the Companies Act 1993. Therefore, the disclosure requirements for limited partnerships are the responsibility of the Ministry of Business, Innovation and Employment (MBIE).

From a tax perspective, limited partnerships are within the recent hybrids announcement meaning, like foreign trusts, they would be taxed in New Zealand to the extent that income is not subject to tax in another jurisdiction.

Base Erosion and Profit Shifting (BEPS) structures

The structures used by multinationals rely on the use of tax havens and exploiting deficiencies in countries':

- tax residency rules – which allow companies to manipulate their tax residence or escape being tax resident anywhere;

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- transfer pricing rules – which allow profits to be stripped out of high tax countries into tax havens through inflated related-party payments, such as royalties and interest;
- controlled foreign company (CFC) rules – these rules are designed to ensure that profits of companies headquartered in, for example the US, cannot be "parked" in tax haven companies without being subject to tax in the US. However, these rules are ineffective and currently, US companies build up large stockpiles of untaxed income in tax havens, however the US companies have been unable to repatriate the cash without paying tax and therefore the cash reserves remain offshore; and
- transparency rules – companies have been able to obtain secret rulings from tax authorities.

The structures that have been used historically should be harder to achieve in future as a result of domestic law reforms undertaken by many countries and the OECD BEPS project.

Ireland has changed its law to address the tax residency rule deficiency that facilitated the arrangement known as the "double Irish" (although companies have until 2020 to phase out its use).

Last week the US introduced the Tax Cuts and Jobs Act which proposes wide-ranging reform to the US international tax settings. This Act includes measures to strengthen the taxation of outbound investment from the US – specifically, improvements to CFC rules, limitation on interest deductions, a 20% excise tax on certain related-party payments and a one-off deemed repatriation of untaxed profits held offshore by US headquartered companies subject to tax at either a 5% or 12% rate. If passed, these measures would be expected to affect the amount of tax multinationals pay in the US on their offshore activity.

More generally, the OECD has issued a 15 point Action Plan that includes recommendations on improving transfer pricing rules, CFC rules, interest limitation rules and eliminating harmful tax practices. The European Union has also issued directives along the same lines as the OECD recommendations.

New Zealand's tax rules already meet many of the OECD minimum standards (for example, our CFC rules are robust and we have no harmful tax practices). We have significantly progressed reforms to:

- improve transfer pricing by incorporating OECD best practise into our domestic law;
- strengthen our existing interest limitation rules;
- prevent "permanent establishment" (PE) avoidance (a PE is a taxable presence in a country, and is required before the profits of an overseas enterprise are taxable in New Zealand);
- address hybrid mismatch arrangements, these measures will prevent companies avoiding tax by structuring their businesses or financing arrangements to take advantage of differences between New Zealand's rules and the rules of other countries.

These measures are scheduled to be included in a Bill to be introduced in December this year, with an application date of 1 July 2018.

In June this year, New Zealand also signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, which amends a worldwide network of several thousand double tax agreements to prevent their use to facilitate tax avoidance.

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