



## 2016 reflections and 2017 crystal ball gazing

### Snapshot

A year is an artificial boundary. Nevertheless, it serves as a useful pause to reflect and look forward.

We have taken the liberty of taking a broad approach to 2017's first taxmail. It is part reflection on 2016's key themes, part crystal ball gazing. We hope it provides some food for thought while backgrounding our thinking for the likely challenges ahead.

The Business Transformation ("BT") and Base Erosion and Profit Shifting ("BEPS") juggernauts unsurprisingly dominated 2016.

We expect that they, along with the NZ election and the impact of global events (including effects of the 2016 US election and UK Brexit vote), will dominate 2017's agenda and discourse.

**2017 is likely to be another challenging year**

**BT and BEPS will continue to be important themes. 2017 is when a number of these changes will start to take effect. Further BT and BEPS proposals are also in the 2017 pipeline**

**The crystal ball element is the impact of this year's election and global events on NZ's tax policy settings**

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## 2016 – it's a wrap

Taxmail started 2016 reporting on [Automatic Exchange of Information](#) ("AEOI") under the OECD's Common Reporting Standard ("CRS"), which will apply in NZ from 1 July 2017. It ended the year with the release of [draft Inland Revenue guidance](#) on how AEOI/CRS would practically apply. In between, there were May and August Tax Bills, enactment of 2015 legislation, and many and varied proposals.

The long list of changes moved us to suggest to the Finance and Expenditure Committee of Parliament ("FEC") that *"it would be good if they could slow down"*. There is a little chance of that. The long list of proposals, never mind their detail, presents a daunting programme.

## BT – 2017: when the rubber hits the road

BT is an ambitious programme to redesign NZ's tax administration. 2017 is when BT will start to "get real" for most. The first [stage](#), a new GST information reporting system, is due in April 2017. (The Kaikoura earthquakes may delay implementation however.)

BT is taking a modular, not a "big bang", approach. The risks with a big bang means a modular reform approach is sensible. However, it has its limitations.

### Whole of system

FATCA has been implemented, AEOI/CRS is being implemented, and [new investment income reporting requirements](#) will be implemented. Each of these expands tax due diligence and reporting by NZ financial institutions on their customers. However, each appears to be designed in isolation. A whole of system approach is required.

### START's capabilities and constraints

Inland Revenue's new technology system, START, is progressively replacing its ageing FIRST system. What START can and cannot do are important constraints on any BT and tax policy proposals. The [late addition](#) to the August 2016 Tax Bill, to allow Inland Revenue flexibility in the transition to START, illustrates that.

However, there is no overview of START which sets out its capabilities to help taxpayers understand what is possible. Future BT proposals should clearly identify any constraints and objectives.

### Taxpayers' rights and obligations

Unsurprisingly, the BT process changes have taken centre stage as they directly affect businesses and taxpayers. There is less focus on proposals that will affect taxpayers' rights and obligations. The August Tax Bill addition and December's Tax Administration Act [taxpayer secrecy proposals](#) are good examples. They deserve attention.

### Taxpayer costs

Back in the day, Inland Revenue checked every tax return. Since then, taxpayers and intermediaries have been required to shoulder most of the burden of assessing, collecting and paying tax. They are unpaid tax collectors.

It is important that BT provides some payback. However, it is likely that short-term costs will be imposed to align business and taxpayers' systems with Inland Revenue's. Those costs need to be minimised.

## BEPS – 2017: be careful what you wish for?

Last November, Inland Revenue advised the FEC that further implementation of BEPS was deferred for private sector feedback. One member responded *"the turkeys are in charge of Christmas"*. Perhaps, but we think it's the right time for a pause and a "cup of tea".

More seriously, there are some important issues to consider.

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### A coherent response is required

Despite the view of many, a quick fix is not the answer. The OECD's BEPS solutions are a pragmatic response. They have been reached through compromise rather than taking principled approaches. The solutions do not necessarily integrate well with New Zealand's tax system. Working through the impact on New Zealand's tax system is necessary to preserve coherence. That is not a quick or easy task, particularly if unintended consequences are to be avoided.

### Unclear global landscape

Standing back, the BEPS proposals have been designed particularly with an EU "base protection" focus. It is uncertain, for example, that the US will accept the solutions as an integrated package. The overall global landscape is at best unclear with the potential to get murkier still.

In relation to FATCA, we have said: "*when the elephant says move, you move*". To use another animal reference, for BEPS, "*when the alpha lions are fighting, the cubs are best to wait for the dust to settle*."

It would be wise to step carefully.

### What is "fair" remains undefined

In November, the Commissioner launched Inland Revenue's 2016 multinational enterprises ("MNE") [compliance guide](#). She said that MNEs should pay their "fair share of tax", echoing the comments of Government and others. She then went on to say that she was confident that most were paying NZ tax "*in accordance with the law*". This echoes the OECD's view that "*Governments make tax laws, companies comply*".

However, the BEPS project will not necessarily result in what social media and some commentators consider fair. A clear statement of what is fair also risks being derailed by misunderstanding (and misuse) of key concepts.

For example, tax is payable on a company's profit, not its sales revenue. The use of historic tax losses and credits for foreign taxes should generally be uncontroversial. Most importantly, questions over who has the right to tax income from capital and who bears the burden of corporate tax are ignored.

Commentary suggests that there will be on-going debate on what is "fair". Achieving a consensus does, however, seem unlikely.

What does this all mean? BEPS is unlikely to be a panacea for the perceived ills of the tax system. Care needs to be taken to ensure that the OECD's BEPS recommendations work for (and not against) New Zealand's interests.

### Sovereignty and constitutionality

A big story of 2016 was the Trans-Pacific Partnership. As well as its trade and investment effects, it raised, for some, questions of sovereignty – should New Zealand give up rights through an international treaty? The US elections appear to have ended that story.

In November, the Government announced that it would sign the OECD's [multi-lateral instrument](#) ("MLI") in 2017. The MLI has the potential to change all of New Zealand's tax treaties to effect BEPS changes. It will change New Zealand's domestic law. That this has passed largely unnoticed is no doubt due to the normality of New Zealand's tax treaties and anti-BEPS being a "good thing".

The interesting point is that treaties are a sovereign rather than Parliamentary power. Parliament is limited to enacting the law which gives effect to a treaty. In New Zealand, the sovereign power is practically held by the Government of the day.

New Zealand's constitution is not in a single document. This makes it difficult to determine who is able to do what. This discussion may seem esoteric but constitutionality is important.

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In tax, the tax legislation generally provides the constitutional context. However, recent decisions like *Trustpower* and *Concepts 124* (where judges raised arguments that neither the taxpayer nor the Commissioner were able to) show taxpayers and Inland Revenue's rights are not self-contained. The judicial function appears to sit outside that statutory context. (As an aside, those judicial arguments seem to us to be inconsistent with the current design of the disputes system and with judgements which have limited the Courts' exercise of its assessment power.)

For an overseas example, the US president is elected not necessarily by a majority of voters but a majority of the Electoral College votes of the different states. The effect of that constitutional requirement is about to play out (again) in the real world.

Understanding how our system works is important to making it work. Sir Geoffrey Palmer and Andrew Butler's proposal "[A Constitution for Aotearoa New Zealand](#)" and the litigation to force a UK Parliamentary vote to effect Brexit raise an opportunity to consider the New Zealand context.

### Impact of global events

If 2016 heralded the rise of populism and economic nationalism, 2017 is when the first round effects are likely to be felt. The incoming US administration wants a dramatic reduction in the US company tax rate, from 35 to 15%, to boost local investment. The UK has suggested it may use its tax (and economic) settings as a bargaining chip with the EU for market access in Brexit negotiations. Increasing tax competition will sit alongside any BEPS changes. Upcoming elections in Germany, France and the Netherlands could reinforce the 2016 wave or signal the tide going out.

For New Zealand, the impact of global events on our tax policy settings will not be able to be ignored. Particularly when...

### A general election awaits later this year

In December we considered the [Opportunities Party's asset tax policy](#). (We suggested that it might be a hard sell but the debate was worth having.) As other parties' tax policies come to light, taxmail will analyse and report on these.

We expect tax will be an election issue. The signs are that income inequality and the role of the tax system will be a particular focus.

We think the 2010 Tax Working Group laid out sensible and reasoned approaches to considering tax policy. We hope that the parties' tax policies will be focussed on promoting good policy rather than good politics.

### Welcome Minister

2016 closed in the same way as 2015, with the appointment of a new Minister of Revenue. The last Minister found 2016 had some unexpected challenges. The new Minister will be hoping that 2017 is more predictable. We wish her well.

### In case you missed it, some summer reading

We have minimised detailed references in this taxmail. Further detail can be found in our 2016 [taxmails](#) and [submissions](#). For BEPS comments, see particularly our submission on [addressing hybrid mismatches](#).

### For further information

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