



## BEPS – the OECD nails it?

### Snapshot

The severe impact of the Global Financial Crisis on Governments' tax revenues, and public disclosure of multi-nationals' tax affairs, has generated a political will, previously absent, to change the global tax system.

The critical question is which country should have the taxing right? The answer: ensure that tax is paid where the economic activity is based. Preventing double non-taxation is key. The OECD has provided its blueprint to achieve that objective.

So has the OECD nailed Base Erosion and Profit Shifting ("BEPS")? This will depend on what gets through. Governments now need to consider BEPS implementation. Domestic and political considerations will take centre stage, including for NZ.

Taxmail focuses on New Zealand's path to implementation, if it proceeds, of the OECD's recommendations. A key area to monitor will be interest deductibility. The New Zealand Government's proposals are expected to work their way through the Generic Tax Policy Process in due course.

NZ businesses with a cross-border presence, or facing international competition, should consider progress on all of the BEPS action items. This is particularly important where other countries are likely to change their rules.

**While the degree of consensus in getting to this stage has been commendable, achieving similar or greater accord on implementation on the OECD's recommendations will be much harder.**

**Different countries will have different domestic and political considerations, which may affect both their timing and ability to implement.**

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## What is being proposed?

### Overview

The OECD has released its final recommendation on the 15 BEPS action items identified in mid-2013.

While the G20 Finance Ministers have welcomed the recommendations, the ultimate success of BEPS will be dependent on each country implementing the recommendations. Each country's tax rules will need to change to align.

While the degree of consensus in getting to this stage has been commendable, achieving similar, or greater, accord on implementation will be much harder than keeping everyone "on the bus", while the proposals were being developed.

This is because different countries will have different domestic political considerations, which will affect their ability to implement. However, alignment is important in preventing the gaps which currently allow taxpayers operating across borders to escape taxation. This may present a *catch-22* situation for the international community.

Further, not all of the OECD's recommendations were agreed as minimum standards. This implies that not all countries fully accept all of the recommendations. The reports also outline on-going, follow up, work that is needed. The recommendations therefore remain a work in progress.

As an aside, the OECD has raised the prospect that the BEPS process will result in lower corporate tax rates around the world. For many countries, this will depend on their Government's fiscal position, with some in a much better position than others. Again, this could make international consensus more difficult to forge.

Some useful summaries of the OECD recommendations include:

- The OECD's explanatory statement on BEPS – [link](#)
- KPMG's summary of the BEPS reports – [link](#)
- KPMG Australia's summary of each action item (including a page count for each action item, for those of a statistical inclination) – [link](#)

### New Zealand's path to implementation

We have organised the BEPS action items into the following categories:

- **Committed** – apparent consensus so that implementation is likely by all countries.
- **Apparent consensus** – no explicit statement but commitment to on-going work indicates general acceptance.
- **Policy direction agreed but not a minimum standard** – if these items are implemented there will be a minimum standard.
- **Best practice/guidelines** – different policy objectives mean that an agreed minimum standard is not feasible.
- **Not all countries have agreed** – although consensus has not yet been reached, on-going work suggests that change is likely.

Action item	Key action	New Zealand's path to implementation, if accepted	Applies to me?
<b>Committed</b>			
<b>Action 6: Prevent treaty abuse</b>	Introduce limitation of benefits ("LOB") or a principal purpose test ("PPT") in Double Tax Agreements ("DTAs").	Some of NZ's newer DTAs already have an equivalent test.  A multilateral instrument may implement LOB / PPT for the rest.	
<b>Action 5: Harmful tax practices</b>	Alignment of R&D activity with intellectual property ("IP") ownership.  Automatic exchange of tax rulings.	NZ currently does not have a specific IP tax regime.  No current proposals to exchange tax rulings but multilateral tax assistance convention may already facilitate this.	
<b>Action 13: Country by country reporting</b>	Master and local documentation of key activity and financial data. Initial application to groups with more than €750m turnover.	Potentially able to be requested under current powers by Inland Revenue, but may have specific rule legislated to confirm taxpayers have to comply.	
<b>Action 14: Dispute resolution</b>	Minimum standard for Mutual Agreement Procedure ("MAP") to be enforced.  Arbitration to be advanced through multilateral instrument.	No specific changes required.  NZ is one of the countries which has committed to arbitration.	
<b>Apparent consensus</b>			
<b>Action 1: Digital Economy</b>	No specific direct tax changes agreed for the digital economy; other actions apply equally as digital economy is increasingly becoming "the economy".  Indirect taxes (GST) should apply in the country of consumption.	Consultation on applying GST to cross-border services, intangibles and goods was undertaken in August 2015.  Introduction of legislation to implement GST on cross-border services is expected shortly.	
<b>Action 11: Measuring BEPS</b>	Indicators of BEPS activity outlined and further work recommended as data is inadequate.	No specific response currently indicated.	
<b>Action 15: Multilateral instrument</b>	Negotiation of a single instrument to amend existing DTAs in accordance with recommendations of other actions.  Approximately 90 countries have joined a group to progress this.	NZ is expected to be a party to these negotiations as a means of implementing recommendations for: <ul style="list-style-type: none"> <li>● Action 2 Hybrid rules;</li> <li>● Action 6 Treaty abuse;</li> <li>● Action 7 PE avoidance;</li> <li>● Actions 8-10 Transfer pricing guidelines;</li> <li>● Action 13 Country-by-country reporting exchanges; and</li> <li>● Action 14 dispute rules.</li> </ul>	

Policy direction agreed but not minimum standards			
<b>Action 2: Hybrids</b>	Domestic rule changes to prevent multiple deductions (for entities) and deductible/non-taxable results (for financial instruments).  Achieved through a primary and secondary rule construct.	The primary rule (to deny deductions if the amount is not taxed) is not explicitly in place. The secondary rule (to tax payments, if other jurisdictions allow deductions) is in place for exempt income.  Proposals for further changes expected to be released for consultation in 2016.	
<b>Action 4: Interest deductions</b>	Deductible interest limited to 10 to 30% of EBITDA.	NZ's thin capitalisation rules (based on debt:asset ratios) are not compliant.  Proposals for changes expected to be released for consultation in 2016.  A review of NRWT on interest is already underway. Amending legislation is expected in early 2016 with likely application from 1 April 2017.	
Best practice/guidelines			
<b>Action 3: Controlled Foreign Company rules</b>	Six building blocks recommended for a comprehensive CFC regime while acknowledging that different policy priorities will affect the design of CFC regimes.	The key NZ design feature is the active business exemption (requiring more than 5% passive income before the NZ CFC rules apply). There are no indications that this will be reconsidered in light of the OECD's CFC recommendations.	
<b>Action 12: Mandatory reporting</b>	Disclosure regime for arrangements which have specific or general hallmarks of aggressive or abusive transactions.	No specific current regime in NZ but in part addressed by the binding rulings regime which encourages pre-implementation disclosure to Inland Revenue.  There are no indications of a broader regime being considered.	
Not all countries have agreed			
<b>Action 7: Permanent establishment avoidance</b>	A Permanent Establishment ("PE") to include a person who habitually plays a principal role leading to the conclusion of contracts and also sole agents.  Further work is required to confirm what profits should be attributed to such PEs.  Multilateral instrument likely to be required to implement.	NZ's specific position is not yet clear.  This is one of the more important issues for New Zealand's tax base as other countries seek to tax the activities of our exporters.	
<b>Actions 8 to 10: Transfer pricing</b>	Alignment of taxation of profits with economic activity and the actual conduct of the parties including the control of risks.  To be achieved through modification of the OECD's Transfer Pricing Guidelines.	New Zealand follows the OECD's Transfer Pricing Guidelines.  We expect changes to the Guidelines, once agreed, will be adopted domestically.	

## Our view

**Taxmail** considered New Zealand's position at the beginning of the OECD BEPS project. Little has changed with the release of the OECD's final recommendations 2 years later.

New Zealand needs to carefully consider the recommendations for their impact on its objectives. Getting tax right on imported capital and exports remains critical to New Zealand's economic wellbeing and prosperity.

For New Zealand business, even if little changes here, you will need to monitor and plan for changes wherever you do business.

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