7 March 2014

Inquiry into the Services Sector
New Zealand Productivity Commission
The Terrace
WELLINGTON 6143

Dear Sir / Madam

BOOSTING PRODUCTIVITY IN THE SERVICES SECTOR – 2ND INTERIM REPORT

The Corporate Taxpayers Group ("the Group") is writing to comment on the Productivity Commission's 2nd interim report, "*Boosting productivity in the services sector"* ("the report").

By way of background, the Group is an organisation of major New Zealand companies that works with key Inland Revenue and Treasury Officials to achieve positive changes to tax policy in New Zealand.

The objective of the Group is to pursue the principled interests of its members in the tax sphere. Significant stakeholders of Group members are New Zealander's, and therefore a New Zealand economy and society that functions well is in the interest of the Group.

The practical experience of Group members enables it to encapsulate general economic concepts into principles that guide and underpin its submissions.

The Group's submission focuses only on the following recommendations in the report:

- R8.1 - New Zealand should negotiate taxation arrangements with other countries that allow more efficient temporary transfer of employees between New Zealand and those countries [including the United States, United Kingdom, Canada and China]. [Page 165]

- R9.3 - New Zealand should promote – and participate in – international forums with the aim of reducing the ability of multi-national firms providing digital services to shift their profits across national borders to avoid paying tax. [Page 187]

1. Efficient temporary cross-border transfer of employees

1.1. The Report notes the following in relation to the temporary transfer of staff between jurisdictions:

> *The Commission, in its trans-Tasman joint study with the Australian Productivity Commission, found that trans-Tasman double taxation arrangements posed a barrier to the efficient transfer of temporary staff between Australia and New Zealand. It recommended that "[t]axation of non-resident employees should be considered when the double taxation arrangements between Australia and New Zealand are next reviewed".*
>
> *A number of New Zealand-based companies transfer staff to and from countries other than Australia, including the United States, United Kingdom, Canada and China. New Zealand's mutual taxation arrangements with these countries may also be a barrier to the efficient temporary transfer of staff between countries.*

Contact the CTG:
c/o Alex Mitchell, Deloitte
PO Box 1990
Wellington 6140, New Zealand
DDI: 04 470 3778
Email: alexmitchell@deloitte.co.nz

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

1.2. The Group is pleased that the Commission has recognised that tax inefficiencies arise from the temporary transfers of employees between countries, and that this issue is wider than New Zealand's relationship with Australia. Such limitations are inherent in New Zealand's mutual tax arrangements with other key trading partners.

1.3. This is an issue the Group has had on its high priority work list for around three years and while Inland Revenue Officials have been open to discussion on possible changes to the current regime no reform has been achieved to date. We see non-resident employee tax issues as a key way to increase the efficiency of transferring staff between countries, and specifically Australia, which is why it ranks highly on our priority list.

1.4. New Zealand's tax agreements with other jurisdictions are based on the Organisation for Economic Cooperation and Development ("OECD") model convention. Under these agreements, referred to as Double Tax Agreements ("DTAs"), the taxation arrangements applying to employees travelling to perform services in another jurisdiction is generally dependant on whether their employer has a "permanent establishment" in the jurisdiction they are sending the employee to. A permanent establishment ("PE") is broadly defined to mean "a fixed place of business through which the business of the enterprise is carried on", and can be interpreted very widely to exist in a range of circumstances. DTA's generally provide that where an entity has a PE in a country in which they are not resident, that country has the right to tax business profits derived in that state.

1.5. For example, as the Group has raised in the past, the Australia-New Zealand DTA allows Australian employees to travel to New Zealand and provide services on behalf of their employer for 183 days in a 12 month period, <u>without</u> the income they receive from this employment being taxable in New Zealand. This applies equally to New Zealand employees providing services in Australia. However, if the employee remains in the other jurisdiction for more than 183 days, then their salary becomes taxable in the jurisdiction in which they are providing services from the first day they arrived.

1.6. This same rule is generally applicable in the DTA's we have with other jurisdictions.

1.7. However, where the business providing services in New Zealand has a PE in New Zealand (discussed above), and takes a deduction against revenue derived in New Zealand for the remuneration it pays to the employee providing services in New Zealand, the DTA concessions do not apply.

1.8. Where the DTA does not apply, the domestic rules in the Income Tax Act determine the treatment. New Zealand's domestic law provides an income tax exemption for employees that are present in New Zealand for less than 92 days in a tax year. If an employee exceeds the 92 day threshold their salary will be taxable in New Zealand from the first day they have arrived.

1.9. The effect of this rule is that the overseas employees, with expertise in a range of industries, are generally <u>restricted to being in New Zealand</u> for 92 days or fewer, in order for the amount of remuneration derived to not be deemed income in New Zealand for tax purposes.

1.10. There are various compliance cost issues associated with dealing with the situation when the 92 day threshold is crossed, including applying for an IRD number, filing New Zealand income tax returns etc. Non-resident businesses may also need to register as an employer with Inland Revenue, deduct PAYE and file PAYE returns with Inland Revenue. Therefore employers will generally avoid having to deal with such costs by sending their employee home before the 92 day threshold is breached.

1.11. This issue is arising more frequently than in the past as the world becomes more globalised and New Zealand seeks international expertise. However it is also arising because the Inland Revenue is taking a more expansive view as to what circumstances will give rise to a PE in New Zealand. Therefore in more and more circumstances, the time an employee can spend in New Zealand without giving rise to material compliance issues is 92 days, as opposed to 183.

1.12. Clearly this can drive inefficient commercial behaviour, as there is a strong incentive to send a particular employee back to their home jurisdiction on day 92, and replace them with another individual rather than incur the compliance costs of dealing with tax matters which can be quite complicated on an individual by individual basis, noting that in many instances the employee is also being taxed on the income in their home jurisdiction. While a credit may be available in the employee's home country for tax paid in New Zealand, such that double taxation is ultimately eliminated this is generally not achieved until tax returns are filed in both the home and host countries. In the interim PAYE or similar withholding will often be required in both countries, which can have significant cash flow implications, especially for small businesses.

Solution One

1.13. In the Group's view, the most effective mechanism to mitigate this inefficiency is to increase the domestic threshold from 92 days to 183 days, therefore ensuring that the employee does not have to rely on the provisions of a DTA. This will ensure that employees performing services in New Zealand will have the same tax obligations regardless of whether their employer has a PE in New Zealand.

1.14. There is precedent for such a universal change; New Zealand has domestic legislation specifying that NRWT payable on fully-imputed dividends is zero percent where the non-resident has a direct voting interest of ten percent or more. The zero percent rate of NRWT applies regardless of the jurisdiction in which the shareholder resides and makes reliance on DTA's unnecessary.

1.15. We note that this goes beyond the scope of the Commission's recommendation to simply negotiation taxation arrangements with other countries, which we believe is more of a piecemeal and time consuming process.

Solution Two

1.16. An alternative option, more in line with what the Commission has recommended, is to introduce specific secondment provisions in New Zealand's DTA network that would allow an employee to be seconded for up to 183 days.

1.17. The Australia-NZ DTA has a secondment provision in Article 14(4), however this is limited to 90 days. The Group has discussed with Inland Revenue requesting that this provision be extended to 183 days in the next round of negotiation with Australia, which the Group understands is scheduled for 2015.

1.18. By the same token, the Group believes that a 183 day secondment provision could be included in DTAs with New Zealand's other key trading partners.

1.19. The main issue with this solution is that it will take many years to process into New Zealand's extensive DTA network. In the interim, the economic inefficiencies that arise will only continue to hamper productivity, as globalisation and the use of international expertise continues to grow as a necessity.

2. Base Erosion and Profit Shifting ("BEPS")

2.1. The Group supports the recommendation (R9.3) that New Zealand should participate in international forums on what is frequently referred to as "Base Erosion and Profit Shifting" ("BEPS"). The Group has taken an active role in discussing and providing input to Officials in this regard. However, the nature of the Commission's concerns and its relationship to productivity in the services sector could be further articulated.

2.2. International tax rules as developed by the United Nations and OECD aim to increase the free-flow of trade and capital by reducing the possibility that trade in goods and services and cross-border capital will be penalised by the imposition of double taxation as one country taxes on a source and the other taxes on a residence basis. In effect, and very broadly, this avoidance of double taxation is achieved by allocating all income from the production of goods or services to where such goods or services are produced. That profit is then jurisdictionally allocated to productive inputs – land, labour, capital and Intellectual Property – in accordance with international rules. Importantly there is no place in this framework for taxing goods or services on the basis of their market – where they are consumed. Given that there is no apparent inclination to remove tax in the jurisdiction where goods or services are produced, taxing also where they are sold would seem inherently to result in double taxation, hindering international trade and capital flows.

2.3. We therefore challenge the notion that the Commission's Report seems to advocate, that moving to allocate taxable income to the jurisdiction where goods or services are marketed would promote productivity in the New Zealand service sector. It could have the opposite effect of penalising international trade. One consequence would be that New Zealand exporters of goods and services would then face tax on profits arising from New Zealand production as well as tax on where goods and services are sold.

2.4. The OECD and other commentators have highlighted how deficiencies in some countries' tax rules have facilitated the double non-taxation of multinational enterprises, especially those operating in the digital economy. It is important to note, however, that this is the apparent result of some multinational enterprises resident in some jurisdictions being able to allocate artificially low profits from production from high tax to low tax jurisdictions. This is not an argument for taxing where goods and services are sold.

2.5. It is useful for international forums to identify ways that deficiencies in some countries tax laws could be corrected. However, in that regard, New Zealand is generally recognised to have very robust international tax rules. Our rules can possibly be improved in some respects (the recent proposals by the government with respect to our thin capitalisation rules provides an example) but there is little evidence that they are hindering productivity in the New Zealand services sector. The Commission's Report does not provide any such evidence.

2.6. Ultimately, our concern is that the Commission's comments on page 187 of its report may be interpreted to give support to measures that would impose tax penalties on international trade and the movement of capital. We agree that BEPS is an important international tax issue and for that reason any proposed reforms require a clear and thoughtful analysis.

2.7. Please contact us if you would like to clarify any comments made in this submission. If it would be useful, we would be happy to meet with you to work through our submission.

For your information, the members of the Corporate Taxpayers Group are:

1. Air New Zealand Limited
2. Airways Corporation of New Zealand
3. AMP Life Limited
4. ANZ Bank New Zealand
5. ASB Bank Limited
6. Bank of New Zealand
7. Contact Energy Limited
8. Chorus Limited
9. Downer New Zealand Limited
10. Fisher & Paykel Healthcare Limited
11. Fletcher Building Limited
12. Fonterra Cooperative Group Limited
13. General Electric
14. IAG New Zealand Limited
15. Infratil Limited
16. KiwiRail Limited
17. Lion Pty Limited
18. Meridian Energy
19. Methanex New Zealand Limited
20. New Zealand Post Limited
21. New Zealand Racing Board
22. New Zealand Steel Limited
23. Opus International Consultants Limited
24. Origin Energy New Zealand Limited
25. Powerco Limited
26. Rio Tinto Alcan (New Zealand) Limited
27. Shell (Petroleum Mining) Company Limited
28. SKYCITY Entertainment Group Limited
29. Sky Network Television Limited
30. Telecom New Zealand Limited
31. The Todd Corporation Limited
32. TOWER Limited
33. Turners and Growers Limited
34. Vodafone New Zealand Limited
35. Westpac New Zealand Limited
36. ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

John Payne
For the Corporate Taxpayers Group