



# **International treaty examination of the Agreement between the Government of New Zealand and the Government of the People's Republic of China for the Elimination of Double Taxation**

Report of the Finance and Expenditure  
Committee

July 2019

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Dr Deborah Russell  
Chairperson

# Agreement between the Government of New Zealand and the Government of the People's Republic of China for the Elimination of Double Taxation

## Recommendation

The Finance and Expenditure Committee has examined the Agreement between the Government of New Zealand and the Government of the People's Republic of China for the Elimination of Double Taxation. The committee recommends that the House take note of its report and note that the Government intends the agreement to be implemented by Order in Council.

## Introduction

On 1 April 2019 in Beijing, New Zealand signed the Agreement between the Government of the People's Republic of China and the Government of New Zealand for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance, and its accompanying Protocol. This new double tax agreement was negotiated to modernise and replace the existing agreement signed in 1986 and amended in 1997.

The new agreement intends to provide cross-border investors with more certainty about tax treatment, particularly for dividends, interest, and royalties. It will do this by reducing withholding rates on certain dividends and eliminating double taxation. This is in line with similar agreements recently concluded by New Zealand with other major investment partners including Australia, Singapore, Hong Kong, the United States, Japan, and Canada.

The new agreement also reflects recent work by the Organisation for Economic Co-operation and Development (OECD) on base erosion and profit shifting (BEPS). The new agreement includes a number of anti-BEPS measures to improve the ability of both countries to detect and prevent tax evasion.

## Application of the treaty

The new agreement will not change New Zealand's tax policy or impose new taxes. Instead, it requires the Governments of China and New Zealand to restrict their taxing rights on a reciprocal basis. It also requires the two countries' tax authorities to assist each other by exchanging tax information and by collecting taxes if requested by the other tax authority.

Section BH 1 of the Income Tax Act 2007 allows the Government to give effect to double tax agreements by Order in Council. Once an Order in Council has come into force, the New Zealand Government can exchange diplomatic notes with the Government of the People's Republic of China, at which point the agreement will come into force.

## **Our view on the agreement**

We welcome the agreement and hope it will make cross-border trade and investment easier. We thank the Inland Revenue Department for its work on the agreement and encourage the Government to speedily bring it into force.

A copy of the Inland Revenue Department's analysis of the agreement is attached.

## **Appendix A**

### **Committee procedure**

This treaty was referred to us on 30 May 2019. We met between 12 June and 24 July 2019 to consider it. We called for public submissions with a closing date of 20 June 2019. We received submissions from the Inland Revenue Department and the New Zealand Superannuation Fund and heard oral evidence from the Inland Revenue Department and the Ministry of Foreign Affairs and Trade.

### **Committee members**

Dr Deborah Russell (Chairperson from 24 July 2019)

Michael Wood (Chairperson to 23 July 2019)

Hon Amy Adams (to 23 July 2019)

Kiritapu Allan

Andrew Bayly

Rt Hon David Carter

Tamati Coffey

Hon Judith Collins

Hon Paul Goldsmith (from 23 July 2019)

Ian McKelvie

Greg O'Connor (from 23 July 2019)

Willow-Jean Prime

David Seymour

Fletcher Tabuteau

Dr Duncan Webb

## **Appendix B**

### **National Interest Analysis**

The National Interest Analysis, prepared by the Inland Revenue Department, is attached.

**NATIONAL INTEREST ANALYSIS:  
Double Tax Agreement with the People’s Republic of China**

**1. Executive summary**

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1.1. On \_\_\_\_\_ in \_\_\_\_\_, New Zealand signed the *Agreement between the Government of the People’s Republic of China and the Government of New Zealand for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance* and its accompanying Protocol (collectively, “the new DTA”). The new DTA has been negotiated to replace the existing double tax agreement (DTA) signed in 1986, as amended by the Second Protocol in 1997 (collectively, “the existing DTA”).

1.2. DTAs are bilateral international treaties that are principally designed to encourage growth in economic ties between countries. They do this by reducing tax impediments to cross-border services, trade and investment, and relieving double taxation by allocating taxing rights between the jurisdiction where income arises and where the recipient is resident.

1.3. New Zealand has 40 DTAs in force, primarily with major trading and investment partners. A major component of New Zealand’s DTA work programme is to keep New Zealand’s existing DTA network up-to-date and reflect developments in modern treaty standards. Since 2008, New Zealand has gradually updated existing DTAs with major investment and trading partners to implement lower withholding tax rates – including those with Australia, United States, Singapore, Hong Kong, Canada, and Japan, accounting for six of New Zealand’s top 10 investment partners.

1.4. As at March 2017, the People’s Republic of China (China) was New Zealand’s seventh largest investment partner with \$6.6 billion of inbound investment stock originating from China and outbound investment stock of \$2.5 billion (source: Statistics New Zealand). In addition, China is currently New Zealand’s second most significant trading partner, with total bilateral trade of \$24.8 billion in the year to September 2017 (source: Statistics New Zealand).

1.5. The new DTA updates the existing DTA to reflect international developments and changes in each country’s treaty policy since 1986. The new DTA is intended to ensure the arrangements governing double taxation between New Zealand and China are up-to-date and provide the levels of certainty and protection that taxpayers expect from a modern treaty. The new DTA therefore represents an improvement on the existing DTA and because of this should be welcomed by taxpayers. The DTA is expected to enhance New Zealand’s cross-border trade and investment by providing greater certainty in respect of the taxation of cross-border income, reducing compliance costs, and lowering withholding taxes on dividends with rates in line with New Zealand’s broader tax treaty strategy.

1.6. The new DTA also includes safeguards arising from the Organisation for Economic Cooperation and Development’s (OECD) recent work on base erosion and profit shifting (BEPS), and included in the 2017 OECD Model Tax Convention on Income and Capital, to

prevent treaty shopping and other forms of treaty abuse. New Zealand and China are also signatories to the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the MLI), which would result in some of the same BEPS provisions applying to the existing DTA, if the MLI is ratified. However, the new DTA includes provisions that were not selected by both countries at the time the MLI was signed, so the new DTA will provide further protection against treaty abuse as compared with the existing DTA and MLI.

## **2. Nature and timing of the proposed treaty action**

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2.1. The *Agreement between the Government of the People's Republic of China and the Government of New Zealand for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance* and its accompanying Protocol (collectively, "the new DTA") was signed in \_\_\_\_\_ on \_\_\_\_\_. It was signed in English and Chinese, with both texts having equal authority.

2.2. The new DTA has been negotiated to replace the existing *Agreement between the Government of New Zealand and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* and its accompanying Protocol signed in Wellington on 16 September 1986 and the Second Protocol to that Agreement signed in Wellington on 7 October 1997 (collectively, "the existing DTA").

2.3. The proposed treaty action is to bring the new DTA into force in accordance with Article 28 of the DTA. The new DTA will enter into force once both sides have completed their respective necessary domestic legal procedures.

2.4. Before the necessary domestic legal procedures can be completed, the new DTA must undergo parliamentary treaty examination, in accordance with Standing Orders 397-400 of the House of Representatives. Following that, it must successfully be given the force of law in New Zealand by an Order in Council made pursuant to section BH 1 of the Income Tax Act 2007.

2.5. In accordance with Article 28 of that DTA, the new DTA will enter into force once both countries have notified each other all necessary domestic procedures for entry into force have been completed. This notification normally occurs by way of a diplomatic note. The new DTA will enter into force on the thirtieth day following the later of these notes. It is not known when the new DTA will enter into force, but New Zealand expects to be ready to notify China that it has completed its domestic procedures by the end of 2018.

2.6. As each provision of the new DTA comes into effect in accordance with Article 28, Article 28 of the new DTA also provides that the equivalent provision of the existing DTA will cease to have effect. The existing DTA will terminate once all of its provisions cease to have effect.

2.7. Like other DTAs, the new DTA will not apply to the Cook Islands, Niue, or Tokelau.

### **3. Reasons for New Zealand becoming party to the treaty**

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#### *General reasons for New Zealand's conclusion of double tax agreements*

3.1. New Zealand began entering into DTAs in 1947, and currently has a network of 40 DTAs in force, predominantly with New Zealand's main trading and investment partners.

3.2. DTAs are bilateral international treaties that are principally designed to encourage growth in economic ties between countries. DTAs do this by reducing tax impediments to cross-border services, trade, and investment. Some impediments to cross-border economic activity can be addressed unilaterally. For example, New Zealand generally relieves double taxation by unilaterally allowing tax residents who derive foreign-sourced income to credit foreign tax paid against their New Zealand tax liability. New Zealand also unilaterally reduces withholding taxes on certain forms of inbound investment. However, unilateral solutions cannot address all of the issues that arise from cross-border activity. Moreover, the country applying unilateral measures must then bear the full cost of the relief. DTAs address these problems by facilitating bilateral solutions. DTAs enable a wider range of issues to be addressed than is possible unilaterally, and also enable the parties to a DTA to share the cost of providing relief.

3.3. DTA networks make an important contribution to the expansion of world trade and to the development of the world economy, which are key objectives of the OECD. Internationally, the OECD has therefore assumed a leading role in promoting the use of DTAs. In particular, the OECD has produced a Model Tax Convention, and a comprehensive commentary, for member and non-member countries to use as a basis for concluding DTAs. As a member of the OECD, New Zealand is subject to an express recommendation issued by the OECD Council in 1997<sup>1</sup> for all member countries:

*1. to pursue their efforts to conclude bilateral tax conventions ... with those member countries, and where appropriate with non-member countries, with which they have not yet entered into such conventions ...*

*2. when concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention, as interpreted by the Commentaries thereon.*

3.4. At a practical level, DTAs are complex technical documents that provide an interface between two, often conflicting, tax systems. The key stakeholders in cross-border economic activity generally favour DTAs for the following reasons:

*Taxpayers.* A primary concern for any taxpayer contemplating entering into commercial activity in another jurisdiction is that they must comply with the tax and other legal obligations of two separate jurisdictions. This can be perplexing, and obtaining professional advice or tax rulings can be costly and time-consuming. Unique issues also arise from cross-border activities, ranging from complex matters,

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<sup>1</sup> The recommendation follows similar OECD Council recommendations that have been in place since before New Zealand joined the OECD.

such as transfer pricing disputes, to more mundane considerations, such as whether taxes paid in the other jurisdiction are creditable against home jurisdiction tax. DTAs help alleviate many of these problems. They establish a framework for the taxation of cross-border activity and establish a mutual agreement procedure for resolving tax disputes.

*Investors.* Investing across an international border always involves risk. Tax laws are often complex and can change suddenly. DTAs assist investors by specifying the maximum rates of tax that can be applied to dividends, interest, and royalties. These “headline” rates reduce compliance costs for investors by making it easier to determine the after-tax returns on potential investments. The tax rates are “locked in” by the treaty, which means that investors can make business decisions with confidence. To encourage greater inward investment, governments can unilaterally reduce their taxation of investment income. However, lowering tax rates in a bilateral treaty setting ensures that the rates are also reduced on a reciprocal basis by the treaty partner. This provides benefits to New Zealand investors investing offshore.

*Governments.* As double taxation distorts business decisions and generally hinders cross-border economic activity, most jurisdictions unilaterally relieve double taxation of their tax residents (for example, New Zealand tax legislation provides a general tax credit mechanism). However, in the absence of a DTA, a jurisdiction bears the full cost of relieving double taxation itself. DTAs allow the cost of relieving double taxation to be shared. They do this by allocating taxing rights between the jurisdictions concerned, on the basis of internationally accepted principles as set out in the OECD Model Tax Convention. The United Nations (UN) also produces a negotiating model, similar to the OECD Model Tax Convention, but with a greater focus on preserving taxing rights for developing nations. Additionally, most countries tax their residents on income earned worldwide. International cooperation between tax authorities is therefore needed to enable tax authorities to verify that income earned in other countries is reported correctly by tax residents. DTAs facilitate this by authorising the exchange of tax-related information (such as tax records, business books and accounts, bank information and ownership information). The exchanged information assists tax authorities to detect and prevent tax evasion and tax avoidance. This is a key benefit of DTAs for governments.

### *Specific reasons for the new double tax agreement with China*

3.5. The existing DTA with China was signed in 1986. As such, the existing DTA does not reflect international developments or developments in New Zealand’s treaty policies and practices. For example, the existing DTA includes a “tax sparing” provision, which requires New Zealand to provide a tax credit for Chinese tax deemed to be paid but which has not actually been paid due to an exemption in China aimed at increasing investment and development. Since the existing DTA was negotiated, the general consensus is that tax sparing provisions are able to be abused and there are more effective means of achieving these aims. The new DTA removes the tax sparing provisions.

3.6. China is New Zealand's largest trading partner in goods and second largest overall including trade in services. Total trade between New Zealand and China was at approximately \$24.8 billion in the year to September 2017 (source: Statistics New Zealand). In addition, China is New Zealand's seventh largest investment partner, with \$6.6 billion of inbound investment stock originating from China and New Zealand investment in China totalling at \$2.5 billion, as of March 2017 (source: Statistics New Zealand).

3.7. This means that, while there are older treaties in New Zealand's DTA network, China's importance as an investment and trading partner amplifies the effects of any gaps and deficiencies in the existing DTA and therefore the new DTA with China has been a major focus of New Zealand's DTA work programme.

3.8. New Zealand's negotiating model is based on the OECD Model Tax Convention, with some differences that take into account New Zealand's status as a small capital importing nation and other unique features of New Zealand's economy. Therefore, the OECD Model Tax Convention and its associated commentary play an important role in New Zealand's overall treaty policy and New Zealand's DTA network.

3.9. However, the OECD Model Tax Convention and its commentary evolve over time to take account of global developments and to address common problems faced in applying the OECD Model provisions. This means that older DTAs, including the existing DTA, can be difficult for taxpayers and tax authorities to apply and interpret.

3.10. The new DTA will address these gaps and deficiencies and provide taxpayers with the level of certainty and protection that they expect from a modern DTA.

3.11. Notably, a major global focus over recent years has been BEPS – that is, the concern that multinationals are able to avoid paying tax anywhere in the world.

3.12. Both China and New Zealand have been actively involved in the work undertaken by the G20 and OECD to address BEPS concerns. Due to the global nature of BEPS, the BEPS Inclusive Framework was formed for the purposes of the project and includes more than 100 members.

3.13. Part of this work has focused on the role of DTAs and the development of new OECD Model Tax Convention provisions to counter treaty shopping and other forms of treaty abuse, including the avoidance of permanent establishment status. These provisions were included in the 2017 update of the OECD Model Tax Convention, which is also followed by many non-OECD countries.

3.14. The new DTA is the first DTA New Zealand has signed following the release of the 2017 OECD Model Tax Convention and is an important step in the fight against BEPS.'

3.15. Both countries have also signed the MLI, which if ratified by both jurisdictions would result in certain BEPS provisions applying to the existing DTA regardless of whether this treaty action is taken. However, the new DTA includes provisions that were not selected by both countries at the time the MLI was signed, so the new DTA will provide further

protection against treaty abuse as compared with the existing DTA and the amendments under the MLI, which the new DTA will replace.

#### **4. Advantages and disadvantages to New Zealand of the treaty entering into force and not entering into force for New Zealand**

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4.1. As a bilateral instrument, the new DTA involves a trade-off between advantages and disadvantages to New Zealand. On balance, the new DTA is expected to be beneficial to New Zealand and, as DTAs are a negotiated package based on two different starting positions, it represents a good outcome for New Zealand.

##### *Advantages of the treaty entering into force*

4.2. The advantages to New Zealand of the new China DTA entering into force can be summarised as follows:

- DTAs are generally designed to foster increased trade and investment. China is a key trading and investment partner. It is important to New Zealand's interests that a DTA between China and New Zealand remains up-to-date and relevant to the prevailing business environment. The new DTA will update existing arrangements to ensure the DTA provides modern levels of certainty and protection with respect to cross-border income earning activities between the two countries. This is because the new DTA better reflects the current version of the OECD Model Tax Convention and therefore its associated commentary.
- The withholding tax rates imposed on certain dividends have been reduced in line with New Zealand's current strategic approach to treaty withholding tax rates. The dividend withholding tax rate will be reduced from 15% to 5% of the gross amount of the dividends, if the dividend is paid to a company that directly owns at least 25% of the voting power of the company paying the dividend. In addition, a zero rate (rather than 15%) applies to dividends derived by certain government investors, if less than 25% of the voting power is owned by the recipient of the dividends. There is no exemption for government investors for dividend payments in the existing DTA; such dividend payments are currently taxed at 15%.
- The overall allocation of taxing rights under the new DTA largely remains unchanged from existing arrangements. As a net capital importer, New Zealand's DTAs generally provide for further source taxation than the OECD Model Tax Convention and the new DTA is in line with this policy.
- The new DTA is New Zealand's first DTA to be signed following the completion of the work on BEPS and the release of the 2017 update to the OECD Model Tax Convention. With the political and media focus on BEPS in recent years, there has been a sentiment among the general public that multinationals are not paying their fair share of tax. New Zealand's tax system operates on the principle of voluntary compliance, which relies on taxpayers understanding their tax obligations and how

the wider tax system works. An important part of this is that, overall, the tax system is seen to be fair. The new DTA will support the overall integrity of the New Zealand tax system, as it will strengthen New Zealand's ability to tax a Chinese investor's income where there is a New Zealand source and will reduce their ability to misuse the DTA to eliminate tax in New Zealand.

- Opportunities for treaty abuse have been reduced compared with the existing DTA, particularly where there is concessionary treatment or an exemption. For example:
  - *Sovereign immunity*: New Zealand's policy is to be clear that sovereign immunity from tax should be extended to the other Government<sup>2</sup> only where the government investor is not in competition with private investors (for example, where it exercises control over a private business, such as a farm). The existing DTA includes a sovereign immunity provision relating to interest, but not dividends. The new DTA extends sovereign immunity from tax to dividends but only for shareholdings below 25%. It also includes the sovereign immunity provision in relation to interest, but restricts its availability in situations where the shareholding is less than 10%. These safeguards are designed to ensure that foreign government investors do not have a tax advantage over private investors, both domestic and foreign.
  - *Permanent establishments*: the avoidance of permanent establishment status was a major focus of the work on BEPS. The new permanent establishment Article contains a number of the resulting provisions, including an anti-fragmentation rule and anti-contract splitting rule. These are base protection measures that will better enable New Zealand to tax non-residents who do business in New Zealand and have a substantial presence.
- The new DTA also includes a whole-of-treaty principal purpose test which allows the competent authorities to deny DTA benefits if a taxpayer has used a particular structure or arrangement in order to benefit from the DTA (even if it is not the sole purpose of the arrangement). This, along with other provisions, will help to ensure that the new DTA meets the OECD BEPS minimum standard.
- Provisions or Articles that are no longer in accordance with New Zealand's treaty policy or do not reflect international consensus, particularly at the OECD level, have been removed from the new DTA. For example:
  - *Tax sparing*: the existing DTA includes a "tax sparing" provision, which requires New Zealand to provide a tax credit for Chinese tax deemed to be paid but which has not actually been paid due to an exemption in China aimed at increasing investment and development. New Zealand's position

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<sup>2</sup> Or to statutory bodies of the State that perform functions of a governmental nature, as agreed between the countries.

is that such provisions are not effective and can be abused. The new DTA does not contain tax sparing.

- *Teachers and researchers:* the existing DTA provides that a teacher or researcher who is visiting the other country is exempt from tax in that other country for two years. New Zealand has not included this Article in any of its treaties negotiated since the 1980s.

*Disadvantages of the treaty entering into force*

4.3. The disadvantages to New Zealand of the new DTA entering into force can be summarised as follows:

- New Zealand may forgo some revenue because of the reduction in withholding tax rates from the existing DTA. However, the reciprocal nature of the DTA means that these revenue losses due to the reduction in withholding tax rates on Chinese investment in New Zealand will be at least partially offset by increases in revenue when taxing rights are allocated to New Zealand and Chinese tax is correspondingly reduced or eliminated under the new DTA. In addition, under the new DTA New Zealand will no longer be required to provide a tax credit for Chinese tax deemed to have been paid. The revenue cost to New Zealand arising from the reduction in withholding tax rates on dividends is estimated to be \$1.8 million per year. Due to data limitations, it is not possible to estimate revenue effects other than those related to withholding taxes on dividends, interest and royalties. As there are no changes to the withholding tax rates on interest and royalties, the estimated revenue cost is limited to dividends. Further discussion on the revenue impact of the new DTA can be found in paragraphs 8.1 and 8.2.
- There is also a potential for some foregone revenue because the time limits for determining whether building and construction sites and activities relating to the exploration for, and exploitation of, natural resources constitute permanent establishments have increased under the new DTA as compared with the existing DTA (from 6 months to 12 months and 1 month to 183 days, respectively). This means that such activities will need to continue for a longer period of time before New Zealand is able to tax those activities. However, this is business-friendly and should overall have positive economic effects as it will reduce compliance costs for shorter term projects, thereby making them more economically viable. An anti-contract splitting rule is included in the new DTA to ensure that these time limits are not circumvented.
- Inland Revenue could incur some additional administrative costs, in comparison with the existing DTA, through the operation of certain provisions that require the competent authorities to come to an agreement regarding a taxpayer (for example, in the case of the “tie breaker” for a dual resident entity or if one jurisdiction seeks to apply the principal purpose test to deny treaty benefits). While these costs cannot be quantified precisely, they are expected to be small.

- The non-discrimination Article in the new DTA applies to taxes of every kind and description. The corresponding Article in the existing DTA applies only to income tax. This could place constraints on the design of Government policy in certain situations in the future. Some of New Zealand's DTAs already contain the same provision (Australia, Mexico, and Japan) and forms parts of the OECD Model Tax Convention, so this issue already exists.
- While the existing DTA can be terminated at any time, once the new DTA has entered into force, Article 29 provides that the new DTA cannot be terminated until a period of five years has passed. It is rare for countries to terminate DTAs, however, so this "lock-in" is not considered to be a significant disadvantage.

#### *Advantages of the treaty not entering into force*

4.4. It is an option not to enter into the new DTA with China. In that case, the disadvantages identified above will not arise.

#### *Disadvantages of the treaty not entering into force*

4.5. If the new DTA with China does not enter into force, this would mean that the existing DTA, which is out of step with modern international treaty standards and New Zealand policy developments, would continue to apply. A higher withholding tax rate on investment income would continue to apply and there would be a limited ability to address treaty abuse. For example, shareholders who hold more than 25% of the voting power in a company would still be subject to a withholding tax rate of 15% of dividends, rather than the new rate of 5%. As noted in paragraphs 1.6 and 3.15, both China and New Zealand have signed the MLI which will result in certain BEPS provisions applying to the existing treaty (for example, the whole-of-treaty principal purpose test), if the MLI is ratified. However, based on the draft positions taken at the time of signing, none of the strengthened permanent establishment rules that are included in the new DTA would apply to the existing DTA under the MLI.

#### *Conclusion*

4.6. Compared to the existing DTA, the new DTA has only minimal disadvantages and significant advantages for New Zealand. In many respects, it also sets a good precedent for future treaties. It is therefore in New Zealand's interest for the new DTA to enter into force.

## **5. Legal obligations which would be imposed on New Zealand by the treaty action, the position in respect of reservations to the treaty, and an outline of any dispute settlement mechanisms**

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### *Summary of key legal obligations*

5.1. DTAs do not impose requirements on taxpayers. The new DTA will not (and cannot) require the imposition of a tax that is not already imposed under domestic law. Thus the entry

into force of the new DTA will not change underlying tax policy. Instead it requires the Governments of China and New Zealand to restrict their taxing rights on a reciprocal basis. It also requires the two countries' tax authorities to assist each other by exchanging tax information and by collecting taxes if requested by the other tax authority.

5.2. Where income is derived from one country (the country of source) by a tax resident of the other country (the country of residence), the country of residence generally retains taxing rights under the new DTA. The main impact of the DTA is to restrict the ability of the country of source to tax the income in certain circumstances. Where both countries are permitted to tax the income, the DTA requires the country of residence to provide a credit for the tax imposed by the country of source. So, for example, if a Chinese-sourced royalty payment is made to a New Zealand resident, China's taxing right would be limited to a 10% withholding tax, and when New Zealand taxes the payment, we would provide a tax credit for the amount of Chinese tax paid in accordance with the DTA.

5.3. The broad framework for allocating taxing rights under the new DTA is similar to the existing DTA and the current OECD and UN Model Tax Conventions. However, key provisions have changed or been introduced. The new DTA differs from the existing DTA as follows:

- ***Business profits (Articles 4, 5, and 7)***

Similar to the existing DTA, the new DTA will ensure that business profits of an enterprise will be taxable only in the jurisdiction where the enterprise is a tax resident unless profits are derived through a permanent establishment in the jurisdiction of source. In that case, the profits may be taxed in the source jurisdiction. A permanent establishment generally exists in the jurisdiction in question when there is a fixed place of business through which the business of an enterprise is wholly or partly carried on. However, Article 5 includes a number of clarifying and deeming rules that refine the permanent establishment concept. The clarifying and deeming rules are updated in the new DTA to match New Zealand's current standard treaty policy and the updated Article 5 in the OECD Model Tax Convention.

The main changes are that the time limit for a building or construction site to constitute a permanent establishment has increased from 6 months to 12 months and the time limit for activities relating to the exploration for, or exploitation of, natural resources has increased from 1 month to 183 days. A permanent establishment for the provision of services will exist in similar circumstances as under the existing DTA.

However, new safeguards, including an anti-contract splitting rule (located in the Protocol) and the updated OECD dependent agent provision, have also been introduced. These will ensure that permanent establish status cannot be circumvented.

The other notable difference from the existing DTA that affects which country may tax the business profits of an enterprise relates to the provision in Article 4 which deals with entities (for example, companies) that are resident in both countries. Under the existing DTA, this so-called “dual-resident entity” provision provides that for the purposes of the DTA, a dual-resident entity is considered resident where its head office is situated. Under the new DTA, the tax authorities of both countries must come to an agreement where that entity should be treated to be resident for the purposes of the DTA. This may increase administrative costs, but while unquantifiable, this increase is expected to be small, based on our experience of administering similar provisions in some of New Zealand’s other DTAs. This new provision is a BEPS safeguard to ensure that entities cannot easily change their country of tax residence to avoid being taxed on their business profits.

- ***Income from immovable property (Article 6)***

As is the case in the existing DTA, income from immovable property will generally be taxed in the jurisdiction where the property is situated. The new DTA clarifies that rights to explore or exploit property are situated where that property is situated.

- ***Ship and aircraft operations (Article 8)***

As is the case in the existing DTA, profits of an enterprise of a country from the operation of ships or aircraft in international traffic will generally be taxable only in that country. However, the new DTA includes a new rule that will ensure that any profits derived from domestic carriage can be taxed by the country of source. This new rule has been New Zealand’s standard treaty policy since 1995.

- ***Non-resident withholding tax (Articles 10, 11 and 12)***

The new DTA reduces withholding tax rates on dividends, consistent with New Zealand’s broader strategy on treaty withholding tax rates. The main objective of that strategy is to reduce withholding tax rates on foreign non-portfolio dividends received by New Zealand residents. This will reduce tax barriers for New Zealand businesses with direct investments offshore, making it less costly to repatriate foreign profits back to New Zealand where they can be reinvested or distributed to shareholders.

The withholding tax rates in the existing DTA stand at 15% for dividend payments and 10% for interest and royalty payments between China and New Zealand.

Article 10 of the new DTA limits the rate of withholding tax on dividends on a reciprocal basis to 5% if the dividend is paid to a company owning at least 25% of the company making the distribution (in all other cases the rate remains 15%). The rates agreed to in this treaty are consistent with New Zealand’s overall policy

of seeking to reduce rates of withholding taxes for non-portfolio dividends where possible.

Article 10 of the new DTA also introduces an exemption for dividends derived by certain government entities, where less than 25% of the voting power in the company paying the dividends is owned by the Government. This is in line with New Zealand's policy to only provide sovereign immunity from tax only where the investment activity is in the performance of governmental functions and the investment itself is not in competition with private investment. New Zealand's treaty policy is that sovereign immunity from tax should not be available where the Government owns an active business that could be operated privately, such as a bank.

Article 11 of the new DTA retains the existing withholding tax rate of 10% for interest payments. The existing DTA includes an exemption for interest derived by certain government entities. While the new DTA includes a similar exemption, safeguards have been introduced in line with New Zealand's policy on sovereign immunity, as outlined above, to ensure the exemption cannot be used to strip profits out of New Zealand through interest payments.

Article 12 of the new DTA retains the existing withholding tax rate of 10% for royalty payments. Note that the definition of royalties in the new DTA is also wider than the definition in the existing DTA – namely the definition in the new DTA includes ancillary and subsidiary assistance and so-called forbearance payments (made to secure the exclusive right to use property). These definitions are now a standard feature of New Zealand's treaty practice.

- ***Alienation of property (Article 13)***

As is the case with the existing DTA, gains from the alienation of immovable property as defined in Article 6 will generally be taxable in the country of source. Gains from the alienation of ships or aircraft operated in international traffic will remain taxable only in the country of residence. One change from the existing DTA is that income or gains from the alienation of property not specifically mentioned in the Article will be taxable only in the country of residence. However, the new DTA allows the source country to tax the disposal of shares in "land-rich" entities and the disposal of shares where the person making the disposal holds more than 25% of the capital.

- ***Independent personal services (Article 14)***

As is the case in the existing DTA, the new DTA includes an Article relating to the provision of independent personal services. Income from the provision of independent personal services will be taxable in the source country if the person has a fixed base there or is present for more than 183 days in a 12-month period.

- ***Income from employment (Article 15)***

As is the case in the existing DTA, income from employment will be taxable only in the country of which the employee is a resident, unless the employment is performed in the other country and certain other criteria are met.

- ***Directors' fees (Article 16)***

As is the case in the existing DTA, directors' fees may be taxed in the country where the company paying the fees is resident.

- ***Entertainers & sportspersons (Article 17)***

The allocation of taxing rights in this Article generally remains the same as under the existing DTA. That is, the country of source is able to tax entertainers and sportspersons for performances within its jurisdiction, even if the person is only present there for a very short period. The existing DTA includes an exemption for the performance of activities as part of a cultural exchange between the two Governments. The new DTA contains a similar exemption, but it is restricted to exchanges that are wholly or mainly supported by public or government funds.

- ***Pensions (Articles 18 and 19)***

New Zealand's treaty policy is that pensions should be taxable solely in the country of residence due to the fact that the recipient of the pension may not have other sources of income, but will be consuming publicly-funded resources without necessarily having contributed to the tax base over their working life.

The existing DTA provides that pensions and other similar remuneration related to past employment are taxable only in the residence country, while pensions and other similar remuneration not related to employment as well as social security pensions are taxable in both countries (shared taxation). In the case of shared taxation, the source country tax may leave little left for the residence country. The new DTA is in line with New Zealand's treaty policy and removes any boundary issues by providing that all pensions and other similar remuneration will be taxable only in the country of residence.

The one exception is in relation to government service pensions, which will generally be taxable only in the source country, unless the recipient is also a national of the residence country.

- ***Government service (Article 19)***

As is the case in the existing DTA, salaries and wages for services to a Government of one country will generally be exempt from tax in the other country.

- ***Students (Article 20)***

As is the case in the existing DTA, students of one country who are in the other country solely for the purpose of their education or training shall not be taxed in that other country on payments from outside that country received for the purpose of their maintenance, education, or training. However, one change in the new DTA is that the Article no longer covers business apprentices and trainees as it is not in line with New Zealand's current treaty policy.

- ***Other income (Article 21)***

The allocation of taxing rights under Article 21 essentially remains unchanged from the existing DTA. The country of source retains a right to tax income that is not dealt with in the other articles of the new DTA.

- ***Entitlement to benefits (Article 23)***

The existing DTA does not contain an Article relating to the entitlement to benefits. Article 23 of the new DTA provides that, where one of the principal purposes of an arrangement or transaction is to benefit from the DTA, treaty benefits will generally be denied. This Article forms part of the updated OECD Model Tax Convention and part of the new minimum standard relating to BEPS.

- ***Non-discrimination (Article 24)***

The OECD Model Tax Convention and the existing DTA include an Article that prohibits discrimination on the grounds of nationality, situs of an enterprise, ownership of capital, and (in limited circumstances) residence. The new DTA also includes a similar Article, but whereas the existing Article was limited to taxes covered by the DTA (that is, income tax), the corresponding Article in the new DTA will apply to taxes of every kind and description. In addition, the Protocol provides that certain policies and measures are not considered to be discriminatory for the purposes of Article 24.

- ***Other administrative requirements***

As was the case with the existing DTA, both countries will have to comply with various administrative requirements imposed by the new DTA. These include a general requirement to eliminate double taxation by giving credits for overseas tax paid (Article 22), complying with the mutual agreement procedures set out in the new DTA (Article 25), and complying with the arrangements for the exchange of information (Article 26). The main change is that, in the new DTA, New Zealand will no longer be required to provide a tax credit for tax deemed to have been paid in China, but was not actually paid by reason of an exemption.

*Dispute resolution*

5.4. The new DTA contains a “mutual agreement procedure” for resolving disputes. It is important to note that the mutual agreement procedure in the new DTA largely mirrors that in the existing DTA.

5.5. Under this procedure, a taxpayer who considers that they have been taxed incorrectly under the treaty, including in transfer pricing cases, can approach their local tax authority under Article 25 to invoke a mutual agreement procedure. If the tax authority considers the case to be justified, and is unable to resolve the case through its own actions, it must approach the tax authority of the other jurisdiction to seek a bilateral resolution. This bipartisan approach is particularly appropriate in the tax treaty context because a single issue will generally affect a person’s tax position in both jurisdictions. Note that under the mutual agreement procedure the two sides are only obliged to “endeavour” to reach resolution. However, the taxpayer remains free to pursue a case through the courts (including if they do not agree with the decision reached under the mutual agreement procedure).

5.6. The mutual agreement procedure also authorises the tax authorities of the two jurisdictions to collectively resolve any difficulties or doubts about the correct interpretation or application of the new DTA.

## **6. Measures which the Government could or should adopt to implement the treaty action, including specific reference to implementing legislation**

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6.1. Subject to the successful completion of the parliamentary treaty examination process, the new DTA will be incorporated into domestic legislation by Order in Council pursuant to section BH 1 of the Income Tax Act 2007. Section BH 1 provides for the giving of overriding effect to DTAs by Order in Council. However, the override relates only to tax matters, and applies only in respect of the Inland Revenue Acts, the Official Information Act 1982 and the Privacy Act 1993.

6.2. The override of the Inland Revenue Acts is necessary to give effect to the core provisions of the new DTA, which may provide relief from tax that would otherwise be imposed under domestic law. The override of the Official Information Act 1982 is necessary to ensure that confidential communications with the other jurisdiction do not have to be disclosed. The override of the Privacy Act 1993 is necessary to ensure that information regarding natural persons can be exchanged according to the terms of the treaty.

6.3. Article 28 of the new DTA provides for the agreement to be brought into force through an exchange of diplomatic notes between the Contracting States. The new DTA will enter into force on the thirtieth day following the last of these notes. New Zealand will be able to notify China that all procedures required by domestic law have been completed once the Order in Council has entered into force, which will be 28 days after its publication in the New Zealand Gazette. It is expected that New Zealand will be in a position to notify China by the end of 2018.

6.4. Thereafter, the provisions of the new DTA will have effect from various dates, according to the terms of the DTA. The provisions relating to withholding taxes will take effect on the first day of January of the calendar year next following that in which the DTA enters into force. The provisions relating to other taxes will have effect for taxable years beginning on or after the first day of January next following that in which the DTA enters into force.

6.5. Inland Revenue will be responsible for the ongoing operation and enforcement of the new arrangements under the new DTA. A press statement will be published once the new DTA enters into force, before the new provisions take effect, to ensure that practitioners and taxpayers are aware of the changes [(note that the text of the new DTA was made publicly available shortly after signing)]. In addition, the Inland Revenue website will be appropriately updated.

6.6. In the case of concerns relating to the application or interpretation of the new DTA, the Commissioner of Inland Revenue is one of the competent authorities for the purposes of the new DTA. Contact details are available on the Inland Revenue website.

6.7. As an alternative to the above Order in Council mechanism, the new DTA could be given legislative effect by means of the enactment of a dedicated statute. However, this option would unnecessarily increase the amount of primary tax legislation, and is therefore not preferred.

## **7. Economic, social, cultural, and environmental costs and effects of the treaty action**

7.1. The overall economic effects of the new DTA between New Zealand and China are expected to be favourable and will continue long term. The new DTA will enhance the existing investment and trade relationship by ensuring the arrangements governing double taxation between New Zealand and China are up-to-date and provide the levels of certainty and protection that taxpayers expect from a modern treaty. By reducing tax impediments to trade and investment, the new DTA may result in a small increase in cross-border trade and investment between China and New Zealand.

7.2. With the political and media focus on BEPS in recent years, there has been a sentiment among the general public that multinationals are not paying their fair share of tax. New Zealand's tax system operates on the principle of voluntary compliance, which relies on taxpayers understanding their tax obligations and how the wider tax system works. An important part of this is that, overall, the tax system is seen to be fair.

7.3. The new DTA is New Zealand's first DTA to be signed following the completion of the work on BEPS and the release of the 2017 update to the OECD Model Tax Convention. It will strengthen New Zealand's ability to tax a Chinese investor's income where there is a New Zealand source and will reduce their ability to misuse the DTA to eliminate tax in New Zealand. The proposed treaty action of bringing the new DTA into force will assist in supporting the overall integrity of the New Zealand tax system.

## **8. The costs to New Zealand of compliance with the treaty**

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8.1. Data limitations prevent officials from precisely estimating revenue impacts, but officials estimate that the reduction in tax revenue to New Zealand as a result of the lower withholding tax rate on certain dividends will be approximately \$1.8 million per year. This is due to the fact that the new DTA reduces New Zealand's ability to tax unimputed dividends paid by New Zealand companies to Chinese investors. The reciprocal nature of the DTA means there are some offsetting revenue savings from China reducing its taxes on payments to New Zealand investors. This means more income can be taxed in New Zealand, but there is still an overall cost given that Chinese investment stock in New Zealand is much greater than New Zealand investment stock in China.

8.2. Officials expect that any additional revenue impact (outside the reduction in the withholding tax rate on certain dividends) will be minimal because the new DTA is a replacement of an existing DTA, and the allocation of taxing rights generally remains the same between the new DTA and the existing DTA. In addition, as the new DTA includes a number of base protection measures that are not included in the existing DTA (even though some, but not all, will be included if the MLI is ratified), there may be revenue gains through taxpayers' reduced ability to engage in avoidance behaviour. However, due to data limitations these are unable to be quantified.

8.3. Inland Revenue could incur some additional administrative costs, in comparison with the existing DTA, through the operation of certain provisions that require the competent authorities to come to an agreement regarding a taxpayer (for example, in the case of the "tie breaker" for a dual resident entity or if one jurisdiction seeks to apply the principal purpose test to deny treaty benefits). While these costs cannot be quantified precisely, they are expected to be small.

8.4. Compliance costs for New Zealand businesses are expected to be reduced as a result of the treaty action. This is because New Zealand businesses will have clearer and more up-to-date guidance about when they will be liable for tax on activities in China, in line with internationally recognised norms. We are unable to quantify the change in compliance costs, although the reduction is estimated to be small.

8.5. Note that these changes in costs are all ongoing as the new DTA will continue to apply in the future until it is either terminated or replaced.

## **9. Completed or proposed consultation with the community and parties interested in the treaty action**

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9.1. The Treasury and the Ministry of Foreign Affairs and Trade were consulted about the content of this extended NIA.

9.2. No specific private sector consultation has been entered into. Consistent with international practice, officials generally do not consult on the content of tax treaties. With

the exception of a few countries, most jurisdictions do not make their negotiating models public and, therefore, negotiations are also considered to be confidential.

9.3. The Government sets New Zealand's strategic priorities in relation to tax treaties and New Zealand's negotiating model reflects these priorities.

9.4. As noted in paragraph 3.8, New Zealand's negotiating model is also based on the OECD Model Tax Convention. As issues are discussed and considered for inclusion in the update to the OECD Model Tax Convention, the OECD seeks feedback from the public, including the OECD's Business and Industry Advisory Committee (BIAC) which consists of business representatives from around the world. Consultation was also a major feature of the work on BEPS, so while officials have not specifically consulted the private sector on the new DTA, feedback was provided (including by interested parties from New Zealand) while the work on the updated provisions was undertaken at the OECD.

9.5. There is a long-standing informal practice whereby practitioners contact Inland Revenue regarding specific issues with New Zealand's existing DTAs as they arise. This feedback is also used to improve New Zealand's negotiating model and potentially inform future negotiations. The Tax Policy section of the Inland Revenue website also includes a link to the Ministry of Foreign Affairs and Trade's Treaties Online website, which specifies which DTAs are currently being negotiated, and invites interested parties to submit comments regarding negotiations.

## **10. Subsequent protocols and/or amendments to the treaty and their likely effects**

10.1. No further amendments are anticipated at this time. New Zealand will consider future amendments on a case-by-case basis. Any amendments to the new DTA will be subject to the normal domestic approvals and procedures. While there is no amendment clause in the new DTA, amendment would be subject to the usual requirements of the Vienna Convention on the Law of Treaties.

10.2. An accompanying Protocol forms an integral part of the new DTA and was signed at the same time as the main DTA text. Countries often prefer clarifying provisions and departures from their standard treaty model to be located in an accompanying Protocol.

10.3. While there is no formal review planned for the new DTA, the competent authorities for each country remain in contact to resolve any interpretation and application issues. In addition, taxpayers and practitioners are able to raise such issues with the competent authorities. In the case of New Zealand, the Commissioner of Inland Revenue is the competent authority and the appropriate contact details can be found on the Inland Revenue website.

## **11. Withdrawal or denunciation provision in the treaty**

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11.1. Under Article 29 of the new DTA, after the expiry of five years from the date of entry into force, either party may terminate the agreement by giving notice of termination through diplomatic channels. The termination would take effect for withholding taxes for amounts paid on or after the first day of January following the receipt of the notice of termination and for other taxes, for income years beginning on or after the first day of January following the receipt of notice of termination. Article 29 generally follows the approach used in New Zealand's other DTAs.

## **12. Agency Disclosure Statement**

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12.1. Inland Revenue is solely responsible for the analysis and advice set out in this extended NIA, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

12.2. Inland Revenue has analysed the issue of implementing the new DTA between China and New Zealand, and the legislative and regulatory proposals arising from that implementation. As part of that process, Inland Revenue considered the option of not entering into the treaty and therefore retaining the existing DTA.

12.3. The revenue cost to New Zealand from the reduced withholding tax rate on dividends under the new DTA is estimated to be approximately \$1.8 million per year. This figure was calculated using data on the dividends paid to Chinese tax residents over the past five years and associated non-resident withholding tax. This was a static analysis, as it is not possible to account for behavioural changes, nor were changes in investment stock or dividend payment rates taken into account, as these are difficult to accurately predict.

12.4. Due to data limitations, it is not possible to estimate the revenue effect of other provisions in the new DTA. However, officials expect that any additional revenue impact (outside the reduction in the withholding tax rates) will be minimal because the new DTA is a replacement of an existing DTA, and the allocation of taxing rights generally remains the same between the new DTA and the existing DTA.

12.5. If the new DTA is entered into, officials expect compliance costs will decrease, administration costs will increase (but only at the margins), and bilateral trade and investment will increase. However, due to data limitations and, particularly in the case of bilateral trade and investment, uncertainty about behavioural responses, officials are unable to quantify the exact impacts, although they are likely to be minor or small.

12.6. The Treasury and the Ministry of Foreign Affairs and Trade have been consulted about the content of this extended NIA. However, consistent with standard international practice, no wider consultation was entered into. There is, however, a long-standing informal practice whereby practitioners contact Inland Revenue regarding specific issues with New Zealand's existing DTAs as they arise, which is used to improve New Zealand's negotiating

model and inform future negotiations. Generally, there are more issues raised with older DTAs than modern ones. While this informal feedback is helpful in discovering gaps and deficiencies, officials are unable to collect any quantifiable data. Moreover, owing to their hidden nature, good evidence of the scale of BEPS activities is generally difficult to come by. As such, while we may be aware of specific problems, we are unable to determine their scale.

12.7. Inland Revenue is also constrained in terms of its ability to monitor the impact of entering into the new DTA to determine whether the impacts anticipated, such as reductions in BEPS and compliance costs, actually materialise. As such, we must rely on the informal feedback process outlined above.

12.8. Inland Revenue's view is that the policy options considered will not impose additional costs on business interests; nor impair private property rights, market competition, or the incentives for business to innovate and invest; nor override fundamental common law principles.

12.9. There are no areas of incompatibility with the Government's "Expectations for the design of regulatory systems".

Carmel Peters  
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Inland Revenue  
1 February 2018